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LIABILITY INSURANCE

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, IMPACT OF DEREGULATION, AND PRIVATIZATION

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

WASHINGTON, DC, MAY 13, 1987

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LIABILITY INSURANCE

WEDNESDAY, MAY 13, 1987

House of Representatives,
Subcommittee on Antitrust, Impact
of Deregulation, and Privatization,
Committee on Small Business,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2359-A, Rayburn House Office Building, Hon. Dennis E. Eckart (chairman of the subcommittee) presiding.

Present: Chairman Eckart; Representatives Price, Martinez, and Hiler.

Chairman Eckart. The hearing of the Small Business Subcommittee on Antitrust, Impact of Deregulation, and Privatization will please come to order.

Today's hearing marks the first hearing of this subcommittee this year and the first since I have been named as its chairman. And indeed, it is an honor and a pleasure to serve in that capacity.

I have had the opportunity since my election in 1980 to work with a number of members of the small business community. They truly, in northeastern Ohio and throughout the United States, form the backbone of economic growth.

The agenda of the full committee and the subcommittee is going to focus on small businesses, their problems, and how they relate to antitrust, deregulation, and privatization.

In fact, later this month, the subcommittee will be traveling to Akron, OH, to examine the impact of the Goodyear attempted takeover and the consequences for that takeover on small businesses in the Summit County, Akron area.

One of the most important issues, however, facing small business is the question of liability insurance. In fact, last year, small business delegates at the White House Conference chose this issue as the single most important issue facing small business today.

Our full committee has already held several hearings on this topic. I, and my colleagues on the subcommittee, continue to remain interested and intend to participate in insurance legislative debates and markups that will proceed in the next several months.

We are pleased to receive several witnesses today, but, before we do that, let me hear from my colleagues, first acknowledging the fact that our Republican brethren are in a Republican Conference meeting, and will be recognized for opening statements when they join us.

First, let me recognize my friend from California, Mr. Martinez.

Mr. MARTINEZ. Mr. Chairman, I have no statement. I am new on the committee. I am here to learn.

Chairman ECKART. My colleague, Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman.

Would you like me to introduce the witness from my district now, or would you rather have me wait?

Chairman ECKART. Why don't we just call up our witnesses?

Mr. PRICE. Mr. Chairman, it is my pleasure to introduce one of our witnesses this morning, Bill Rankin, Jr., from Raleigh, NC. Mr. Rankin is the president of Carolina Welding Supplies, Inc., which is located in the district I represent, the 4th District of North Carolina.

His small business employs 35 people and distributes welding supplies and compressed gases to industrial customers and scientific and medical facilities. Carolina Welding Supplies was started by Mr. Rankin's father in 1953. It began in one location and has now grown to 4 locations, serving 44 counties in North Carolina and 12 counties in Virginia.

I believe that we need to ensure that these small, family businesses continue to prosper because of their importance to our economy. I really want to thank Chairman Eckart for convening these hearings today on the critical problem of insurance.

I look forward to hearing from Mr. Rankin on the unique insurance problems facing his company and other welding supply companies.

So, I am especially glad to be at this hearing this morning; because our subcommittee has this fine witness from my district.

Chairman ECKART. Let me invite Mr. Rankin to join the panel. Mr. Marcus M. Griffith from Hairlox Co., on behalf of the U.S. Chamber, and from my district, Mr. Tony Debevc, representing Chalet Debonne Vineyards, from Ashtabula County, OH.

Mr. Debevc, let me ask you to go first, and I would remind all the witnesses that your complete written statement will be made a part of the record, and ask you to proceed in any fashion that you see fit.

TESTIMONY OF TONY DEBEVC, PRESIDENT, CHALET DEBONNE VINEYARDS, MADISON, OH

Mr. DEBEVC. Thank you, very much, Mr. Chairman, and members of the subcommittee.

I would like to thank you for allowing me the opportunity to testify before the subcommittee on the issue of liability insurance.

I especially would like to thank Chairman Eckart, whom I have known for a number of years as our Representative, for holding this hearing. As he well knows, the topic is of acute interest to small business owners in northeast Ohio, as well as across the country.

I own and operate, with my father, Chalet Debonne Vineyards, truly, a family farm juice and wine producing operation. Liability insurance in the past 2 years has drastically drained our available cash for channeling many business operations or programs that have made Chalet Debonne Vineyards one of the success stories of our industry.

This unreasonable increase in cost of doing business provides another nail in the coffin of small business. Our particular insurance rates have increased from $4,200 in 1985, to $13,000 in 1987, with drastically reduced coverage, increased exposure, and in many cases, questionably rated insurance underwriters.

We also have been warned that in the coming year, we should expect a 20- to 25-percent increase in rates. Our summer promotional activities—for example, we hold hot air balloon races, art and craft shows, model airplane demonstrations, and such, that we sponsor—must now be all handled through very expensive specialty liability companies.

All of this was previously covered under our general liability insurance.

We are fortunate, for our own particular operation, to be associated with a national Association of American Vintners, which has an insurance program for our members. The rates have been much lower than the average rates for most winery and farm operations. However, in meetings, here in Washington, just this past couple of days, we have found out that our insurance program is in serious trouble and may not survive the coming year.

I have also spoken with other members of our surrounding community, and I am not alone in this dilemma. A fellow small business owner and grape grower in my area has seen insurance rates increase triple on his small operation this last 3 years. Like me, his small business, family-owned, can hardly afford to absorb such increases.

Another small business owner in our area, owns a bowling alley. Not only did he witness a dramatic rise in his insurance rates, but eventually he could find no insurance coverage for his bowling alley. When he did find it, the rates had increased some 600 percent and the coverage was much more limited than his previous policies.

It is not just the small business owner in our area that has been faced with rising premiums and diminishing coverage. The savings and loan in the area and our local volunteer fire department have experienced the same story. Whereas large operations may be able to absorb the increases in the cost of doing business, or at least pass them on to the consumer, with their vast marketing presence, the small business owner is faced with decreased revenues and, in some cases, termination of business.

In my business, we are faced with many other concerns. As Members may know, there are various proposals being discussed in Congress to drastically increase the taxation of wine and alcoholic beverages. We are also being attacked from abroad by cheaper and often, government-subsidized foreign grape products.

Sharp increases in insurance premiums alone help to further reduce our competitiveness, both at home and abroad. Many remedies have been suggested for the insurance crisis.

I am not here today to advocate what remedies should be chosen or debate the merits of them. Instead, I am here to relate to you what experiences small businesses have concerning insurance coverage and solutions that may be taken.

Small business is vital to our national interest, and provides a strong and competitive economy, that keeps monopolistic waste and corruption under control. Small businessmen and women are often the innovator and developer of quality products available to you and me, the consumer in our society.

Thank you, again, the subcommittee and the chairman for allowing me this opportunity to present my views. I would be more than happy to answer any of your questions.

Chairman ECKART. Thank you for flying here and agreeing to be with us, and also my congratulations to you on Chalet Debonne being an award winning winery.

I understand that you have received several medals in a recent competition.

Mr. DEBEVC. We have been very fortunate. We not only have a very strong family operation, which allows me to come here today, and stay over, but we have some very good employees.

We employ eight full-time people in the winery and numerous part-time employees and have grown from, initially, in the late 1960's, from just a grape-farming operation to something now, that has been, I think, a fairly good success story of producing not only wine, but grape juices, and we are even getting into table grapes.

So, we are diversifying. However, the problem of liability insurance is getting worse, I think, and it is becoming more and more difficult for us to compete. I think that our Government needs to look at business, in general, and especially, small businesses, to keep them viable.

Many other countries, I think, have that in the forefront and use the United States as a good place to expand their operations, and we seem to be on the defensive, so often, instead of on the offense.

Chairman ECKART. Thank you.

Representing the National Welding Supply Association, from Raleigh, NC, Mr. Bill Rankin, Jr.

Mr. Rankin.

TESTIMONY OF WILLIAM C. RANKIN, JR., PRESIDENT, CAROLINA WELDING SUPPLIES, INC., RALEIGH, NC, ON BEHALF OF NATIONAL WELDING SUPPLY ASSOCIATION

Mr. RANKIN. Thank you, Mr. Chairman.

Congressman Price, I appreciate your kind words, and the genuine interest which you have shown, since being elected, in seeking to assist the small business community in the 4th Congressional District.

Mr. Chairman, I welcome the opportunity to testify before your committee concerning the effects which the unavailability of insurance and/or the extraordinary rise in insurance premiums have had on the small businesses which comprise the National Welding Supply Association.

From my own experience, and many of my discussions with association members from around the country, I can tell you that the astronomical increases in the cost of insurance over the past 3 years, and for many, the inability to obtain coverage, threaten to force us out of an area, which has traditionally been the domain of the small businessman.

Specifically, as a result of this most recent insurance crisis, there has been a greater exodus of welding supply distributors from the marketplace over the last 30 months, than in the entire time since my father founded Carolina Welding Supplies, over 33 years ago.

For the most part, these businesses have been gobbled up by the industry's large suppliers who are able to foot the insurance bills. In my opinion, this movement toward industry consolidation has adversely affected the communities and consumers which have been serviced by these companies.

Specifically, the passing of local ownership to the industry giants has resulted in less service, higher prices, fewer jobs, and a decline in community involvement. This trend will not be reversed unless something is done quickly to remedy the situation.

First, let me briefly describe the National Welding Supply Association. NWSA is made up of over 1,100 distributors of welding supply and compressed gases. More than 80 percent of NWSA members have gross sales of under $5 million per year. On the average, the typical welding supply distributor employs 26 individuals, and generally speaking, we are family-owned entities, which were founded shortly after World War II. I am quite typical in being the second or third generation owner of a business.

Compressed gas sales comprise the single largest source of revenue for virtually every NWSA member, and account for between 35 and 40 percent of our business. Do not, however, let the term welding mislead you. Many of our customers are on the cutting edge of today's advanced technology. For example, in addition to my industrial customers, I sell a variety of specialty gases to scientific and medical facilities at Duke University, the University of North Carolina, North Carolina State University, and numerous laboratories located in the Research Triangle Park, NC.

While we share many of the same problems faced by other small businesses, I believe that the insurance situation confronting NWSA members is unique and more serious as a result of our involvement with compressed gases. As you probably know, compressed gases are considered hazardous materials under the law. Back in 1980, Congress enacted the Motor Carrier Safety Act, which requires any company transporting hazardous materials to have a minimum of $1 million in liability coverage. Further, companies which haul gases in cargo tank trucks, or sell poison gases must have a minimum of $5 million in coverage.

Companies which fail to comply with these provisions are subject to a $10,000 per day fine. This obviously distinguishes the welding supply distributor from other small businesses in the fact that the law denies NWSA members the option of choosing to operate without insurance.

Let there be no misunderstanding, however, that NWSA has always strongly supported this requirement, believing that these benchmarks represent a reasonable level of coverage for responsible distributors.

In fact, I am unaware of any NWSA member who had less than $5 million in coverage prior to 1984, even if they were not required to by law.

The insurance crisis of the past 3 years, however, has not only made it extremely difficult to get insurance, but it has placed a number of NWSA members in the precarious position of violating the Federal statute. Specifically, those companies which must have

$5 million in coverage, have either been unable to obtain insurance, or have been quoted such exorbitantly high premiums as to effectively preclude coverage.

These companies thus find themselves caught in a disastrous catch-22. They can either purchase the insurance, and watch the erosion of their bottom lines, or operate without insurance in violation of the law.

Those who choose the latter course are in constant fear of a DOT audit, which could lead to the eventual shutdown of their business. I do not believe that Congress could have intended such a result.

Granted, the majority of NWSA members must only obtain $1 million in coverage. Nevertheless, while I believe that every NWSA member now has insurance, most of us have had to pay dearly for this protection.

Let me share some of the insurance cost data which NWSA recently compiled.

For example, the typical NWSA distributor has sales of $3.15 million. In 1984 he paid about $19,000 for $5 million worth of insurance. Two years later, his cost has risen to $52,000 for the same coverage.

The figures are even more discouraging for distributors whose annual sales exceed $5 million. In 1984 these companies paid $62,000 for insurance and the same coverage cost in excess of $223,000 by 1986. And, while most NWSA members have been able to obtain insurance, I am convinced that had this industry not formed a captive insurance company in the mid-1970's, at least 50 percent of us would still be going bare.

The reason is that the major insurance companies and underwriters have decided to either refuse to insure our line of business or are quoting outlandishly high premiums which have no relationship to the generally excellent incident records of our members.

My company is a perfect example. Carolina Welding Supplies has had not a single significant accident in the company's history. Over the years, our premium payments have far exceeded the payouts which our insurers have made in our behalf.

Nevertheless, not a single insurance company other than WESCAP, the industry captive, would quote me a price over the last 3 years. It seems that my company, like so many other welding supply distributors, have been grouped into bad risk categories, notwithstanding our sterling safety records.

As far as I can determine, there is no longer any relationship between experience ratings and the price of insurance.

Finally, I would like to refer back to something I mentioned at the start of my testimony. Nothing has troubled me more over the past 2 years, than to witness distributor after distributor, many of them my father's contemporaries, sell their business to one of the industry's large suppliers of compressed gas.

There are two primary reasons for this unfortunate development. The first culprit is the insurance industry which has sapped the profitability of these businesses through its enormous rate increases. The second, which is closely tied to the first, is the havoc caused by this Nation's existing tort system.

In my opinion, the tort system today, is no more than a lottery which encourages individuals to bring outrageous claims for even the slightest accidents in hopes of hitting the jackpot.

Until we enact a tort system in which liability is based on fault, and limitations are placed on awards, we are unlikely to see any major long-term improvements in the situation.

In closing, I would like to offer a few recommendations, on behalf of NWSA, which we believe could help improve the situation.

In our opinion, the efforts made in a number of States this past year, to combine mandated limits on insurance rate increases with reform of the tort system provides the most positive step toward a meaningful solution. Whether this type of reform can be effectively mandated at the Federal level, is something that only you and your colleagues can decide.

I can only say that some long-term stability and sanity must be achieved, so that the small businessman can escape being victimized by forces beyond his control.

Thank you for your interest, Mr. Chairman. I will be happy to attempt to answer any of your questions.

Chairman ECKART. Thank you, Mr. Rankin.

Next, on behalf of the U.S. Chamber of Commerce, Mr. Marcus M. Griffith from Hairlox Co.

Mr. Griffith you made quite an impression before the Energy and Commerce Committee. I believe that the Small Business Committee can benefit from your expertise, as well.

TESTIMONY OF MARCUS M. GRIFFITH, PRESIDENT, HAIRLOX CO., INC., WASHINGTON, DC, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE, ACCOMPANIED BY ROGER E. MIDDLETON, ADMINISTRATIVE LAW ATTORNEY, BUSINESS-GOVERNMENT POLICY DEPARTMENT, U.S. CHAMBER OF COMMERCE, WASHINGTON, DC

Mr. GRIFFITH. Thank you, Mr. Chairman.

I am Marcus M. Griffith and I am the president of the Hairlox Co., Inc., Washington, DC, which I founded. I am appearing on behalf of the U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce, and trade and professional associations.

I am president of the District of Columbia Chamber of Commerce, and a member of the U.S. Chamber's Council of Small Business, which is composed of small business leaders, who recommend small business policy to the U.S. Chamber's board of directors. The chamber appreciates this opportunity to present its views. It is a pleasure for me to be here.

The full text of my statement has been submitted to this subcommittee for the record.

Accompanying me today, on my right, is Roger Middleton, who is counsel for corporate policy of the U.S. Chamber of Commerce.

The chamber strongly supports Federal product liability reform, a reform that is critical to the vitality of American business. For over a decade, the business community has sought to bring uniformity, predictability, and fairness to our public liability laws.

Our plea is louder today because the need for a uniform Federal product liability law is more urgent than ever. While we are pleased that this subcommittee is holding hearings on product liability, we are disappointed by the failure of Congress to have passed a Federal product liability reform law, by now.

We reemphasize our desire to see Congress pass a product liability reform bill this year. Today, product liability reform is at the cutting edge of a widespread and growing public movement favoring overall tort reform.

It is precisely this outcry for tort reform that prompted the more than 1,800 delegates to last year's White House Conference on Small Business to rank tort reform as their No. 1 policy recommendation and Federal product liability reform as No. 9.

As a delegate to that conference, I fully appreciate how this issue profoundly affects small business. The delegates to the conference were not large corporations, but representatives of small businesses of every type.

Those who still contend that this is a big business issue ignore reality. It is the American small business community whose operations are crippled by protracted litigation.

It is the small manufacturer who finds it increasingly difficult to compete with foreign companies, which are not subject to the threat of product liability suits. It is the small distributor who is more reluctant to market new products for fear of irrational lawsuits which they cannot afford to litigate.

We all have heard by now, more stories than we wish to recount on how this product liability crisis has affected various segments of the American business community. However, Mr. Chairman, if you would allow me, I would like to share with this subcommittee my personal experience.

My company, Hairlox Inc., a hair care product manufacturing firm, has been in business for the past 17 years. This is the first year, in the company's history that I have operated the business without product liability insurance coverage.

Hairlox, like many other small businesses across the Nation, is going bare. Mr. Chairman, this decision to drop my product liability insurance was an extremely difficult decision for me to make, as I know that it has been for many of my colleagues. It was, however, a necessary decision because the costs of product liability insurance for my company, was unaffordable.

Thus, I had to weigh the consequences of operating without product liability insurance from a cost-benefit perspective. The cost of my product liability insurance premiums would have been so expensive, that the probability of deriving any benefit from coverage, was minimal.

Another factor which I had to consider was the fact that my company had never had a catastrophic claim filed against it and that those small claims which had been filed were settled, and I might add, not because of the meritorious nature of the claims, but because of the expense in defending a product liability lawsuit.

Indeed, product liability insurance affordability and availability are the result of problems that businesses face with our current tort system. But, even if product liability insurance somehow was made available to all who wanted it, problems arising from excessive product liability suits would remain, specifically corporate bankruptcies resulting from unending litigation would continue. Product prices would continue to increase to reflect litigation costs and new products would be withdrawn from, or not introduced, into the market by businesses under the threat of lawsuits.

Only where logic and fairness are incorporated into our civil justice system, will these problems begin to correct themselves.

A significant factor in subverting U.S. competitiveness is this Nation's absurd product liability laws. Because U.S. manufacturers bear much higher product liability risks than foreign competitors, they must pay excessive product liability insurance claims, which, in turn, are reflected in the cost of U.S. products and services. Not only are U.S. manufacturers forced to charge more for their products, but also the threat of product liability lawsuits is driving many companies out of basic product lines altogether and is discouraging them from launching new ones.

Our foreign competitors, who are less victimized by U.S. liability laws, and who enjoy more rational systems in their own countries, are at a distinct advantage.

I could go on with examples in the health care field, and the sporting equipment field, and many other fields, but in the interest of time, Mr. Chairman, I would pass on that and just say to you that the U.S. Chamber of Commerce is supportive of legislation such as H.R. 1115, that is, the Uniform Product Safety Act of 1987, introduced by Representative Bill Richardson.

We believe that this legislation would provide meaningful product liability reform. The time has come for Congress to enact meaningful product liability reform. If Congress truly is concerned about this country's competitiveness, this would be an excellent and effective way to demonstrate it.

Product liability reform will enable American producers to compete with foreign manufacturers on a more level liability playing field.

Thank you for inviting us to testify and I would be happy to take any questions that you might have.

[Mr. Griffith's prepared statement may be found in the appendix.]

Chairman ECKART. Mr. Griffith, thank you. The examples that you cited, but did not include in your verbal statement, will be included as part of the record.

Mr. GRIFFITH. Thank you, sir.

Chairman ECKART. Mr. Martinez.

Mr. MARTINEZ. Before I ask the question, it is really my statement that I want you to respond to.

I was a small business owner myself. I was in a business that had the highest insurance rate because of high risk flammability. It got to a point where it pained me every time I had to review my insurance.

One of the things that pained me was that it did not matter which insurance company I went to. The coverage that I got as a bare minimum, would cost me the same amount of money—there was no competitiveness.

I also served on a local city council in which it got to the point that we decided to self-insure by joining with other cities.

I am suggesting that there could be some way for an association with a major membership, as you cited Mr. Debevc, to form an insurance company of their own. I think it was Mr. Rankin who referred to a captive insurance company. I would like an explanation of just what that is—after I finish here.

I see the desperateness and the frustration, but I have always felt that consumers share a certain responsibility in the way that they use a product. I see more and more labels coming out that don't seem to be resolving companies of any liability. As for the labels, they actually do not do any good. There is a need for a major law dealing with labels. Persons who have been required to provide labels, should be relieved of a certain liability. Some of the responsibility or fault if something goes wrong, should be placed on the consumer.

We have not done that, and I think this is a great need. There are many aspects to this issue. As the chairman has cited, it is a complex situation.

But Mr. Rankin referred to several remedies—one of them is limiting rates. I think, along with limiting rates, attorney's fees ought to be limited. As you know, a person seeking compensation for a claim will try to deal with the insurance carrier and then feel that it is not a justified settlement. Then they go to an attorney, and you can get the Moon, the Sun, and the Earth.

And, after the suit, the person receives less than if they had settled because the biggest portion, even though the settlement is greater, goes to the attorney's fees.

So there ought to be a limit on attorney's fees, and this is not in any way meant to demean attorneys, but there have got to be limits there as well.

I think that somehow or another we have got to place limits on claims. For every kind of a claim the insurance industry has experience that can help us set a standard for that payment.

But until the lobbyists for the people that are saddled with this high liability insurance rate start doing a heck of a job, Congress is not going to act. Congress feels that the purview of the States are being superceded and there is a reluctance.

There have been several bills dealing with liability insurance, since I have been in Congress. None of them have really been acted upon. The last time I remember the Senate trying to act on it, the insurance lobby did such a good job, that the legislation went nowhere.

I think that there is enough to convince Congress and make them act. I really think that you have got to do a wholesale job.

But the question is, what is a captive insurance carrier?

Mr. RANKIN. In the early 1970's, the WESCAP insurance company was formed by members of our industry, and members of NWSA, and the members put up a cash contribution to form this company which then handles the quotation process, if you will, for all of those interested in getting a quotation process and handles, also, the first layers of insurance.

The upper layers of insurance are then farmed out to the major companies. In our case, it happens to be Cigna, and we also contract with a firm that handles all the claim activity.

So, I guess, it is more or less, what started as a cash pool to insure the underlying limits of liability, and have a management staff to coordinate the upward limits and the claims process.

Mr. MARTINEZ. Has this held your rates down? It made it easier for you to get insurance, but has it held your rates down?

Mr. RANKIN. I don't think so, in that they are the only people that quote my company. So, I really don't have any experience to answer that question.

Mr. MARTINEZ. You are a captive also?

Mr. RANKIN. That is right.

Mr. MARTINEZ. I am wondering if there has been an effort by the Chamber of Commerce and business, small business organizations in particular, to review H.R. 1115 by Bill Richardson.

Has anybody here reviewed that bill and looked at how it would fit your needs?

Mr. GRIFFITH. Yes; we support H.R. 1115 and the chamber has looked into all of its various aspects. And, as I said, overall it is a good bill and the U.S. Chamber does support it.

Mr. MARTINEZ. Thank you.

Mr. GRIFFITH. As regards to captive, if I may say so, on a personal note, another association to which I belong, the American Health and Beauty Aids Institute, which is comprised of approximately 22 minority manufacturers, whom operate on a national and international scale, we have attempted at several different times to form a captive insurance company, and an offshore company.

It is very difficult. My counselor just reminded me that Federal legislation was recently introduced that assists in the formation of this type of operation, but it is still very costly.

It is very, very costly and really difficult to consummate because you are trying to bring together competitors and persons, many of whom don't want to divulge their inner workings of their individual businesses and that type of thing.

So, from an organizational point of view, it is very difficult to form a captive, let alone the other aspects.

Mr. MARTINEZ. Thank you, Mr. Chairman.

Chairman ECKART. Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman. I want to thank all of the witnesses for appearing here today and for their very helpful testimony.

Mr. Rankin, I would like to especially explore some aspects of your testimony, because of the connection to my own district, and also the general interest of what you said.

You referred to your industry's experience with insurance costs over recent years. I wonder if you could expand upon your own experience, and I welcome the other witnesses to comment as well.

What has been your own company's experience with the cost of insurance in the last 3 years?

Mr. RANKIN. I thought that you might ask that question. Since 1982–83, because our insurance runs mid-year to mid-year, we have had a 65-percent increase in our basic insurance premiums.

That does not include a cash requirement that we had to pay WESCAP in 1985 to raise their level of cash so that they could provide these insurance services, and if you include those funds, that increase in terms of real dollars, outlay dollars, is 229 percent.

Mr. PRICE. So, 229 percent over——

Mr. RANKIN. Between 1982-83 and 1986-87.

Mr. PRICE. How does your experience compare, Mr. Debevc?

Mr. DEBEVC. As I mentioned earlier, we were paying right around $4,000 for that insurance. And now we are paying $13,000, just from 1985 to 1987, this year.

However, what we have done in our operation, being a farm operation, we have had to eliminate some of our coverage. We had a number of different buildings, barns and so forth, storage buildings, that we have just eliminated much of our general—for example, fire insurance, theft, vandalism, on those buildings and taken a chance to be able to afford our regular insurance costs.

If I were to include everything that we included 3 years ago, our insurance would be well over $20,000 and the fact that we have—it is not a captive insurance, but insurance that through our association is quoted as a group, and has received much better rates—I do not know if I could get insurance.

We are in trouble right now with our insurance program and I really do not know where to go. I know that Mr. Kasechik, the fellow who owns the bowling alley I mentioned, had a real problem last year—he could not get insurance. He went barebones, without coverage and the coverage that he has right now is 600 percent higher than he was paying.

His deductibility has gone from $250 to $2,500 in deductibility and he is scared that if he has a break-in or a loss and loses things at his bowling alley, he has to cover up to $2,500-himself.

So, it does not look as bad as it really is. Even though it is a three-fold increase, it could be a five- or six-fold increase for us, simply because we have had to reduce our coverage just to keep costs in line.

So, we are really having our neck out there. Mr. Griffith mentioned that, I mean, you are out there. I know many sleepless nights—here you have worked all of your life, my father has worked all his life, and you have got everything on the line for some individual that is going to win the lottery.

One of our big problems in the liquor industry is the deep pocket syndrome. That is something that is really bad. In other words, if someone comes to our facility and buys our product, and drinks a glass of wine and leaves, but then goes to four or five other wineries in our district there, and ends up getting drunk, ends up killing someone, that person's family can sue the business that caused him to be drunk.

Well, the way that the system works is that I am the largest, more progressive, or the most progressive winery in our district. I probably have more insurance coverage than anyone else.

The way that the system works is that I am the guy who is going to get hit. I was totally legal and I only served the individual one glass of wine, but yet, since I have the deep pocket, I was in the series of getting that individual drunk, or part of it, and so, they will hit me and forget or bypass everyone else. My costs of insurance has to reflect that.

If I sell juice to another winery who makes wine, who gets into trouble, and gets someone drunk or someone let's say, takes a bottle of wine that explodes in his face, for some unknown reason, they can come back and name me as a part of a general suit. Then I have to, at least, try to get my name off that suit, or defend my position, because I supplied part of the raw product.

Those are the types of things that we have absolutely no control over. They have really caused our insurance rates, I think, to go up, and I think that it is something that the Congress can do something about relatively easily because those are unrealistic types of expenses that should not be involved in insurance. I have no control over that.

Mr. PRICE. Mr. Rankin, before my time expires, I do want to get back to a few additional matters that you mentioned in your testimony.

You, of course, are faced with a legal requirement that you carry a minimum amount of insurance coverage. Yet, you state that a number of companies have taken the risk of going without insurance, simply because they could not bear the costs.

Do you know of any specific instances where companies have been audited by the Department of Transportation and have been found to lack the required insurance, and if so, what has DOT done to those companies?

Mr. RANKIN. The only thing that I can speak on, in terms of knowledge that I have, is that I do know that the Department of Transportation has increased their surveillance activity in the last 6 or 8 months.

And that some indications that the businesses that I am aware of, if efforts have been made to obtain insurance, verified efforts, documented evidence, then the Department of Transportation will take that into consideration.

I do not know of any companies that are currently under fines or that are paying fines, or have been shut down by the Department of Transportation, but, I do know of several companies that have been investigated.

Mr. PRICE. Another alarming aspect of your testimony, I think, is the description of consolidation within the industry. You suggest that one factor pushing the disappearance of smaller firms has been the rise in insurance costs.

Can you be a little more specific about that—any instances that can help us understand how that has worked?

Mr. RANKIN. There are probably five major suppliers of industrial gas in this country—major and I mean nationwide. They probably account for, through their distributors or through their direct effort, somewhere in the neighborhood of 75 percent of what is actually sold in the marketplace.

I know of, probably, five companies that have sold their business to these large corporations because the insurance premiums and the other expenses associated with the exposure of this situation, has simply made it either an unprofitable situation for the particular owners, or that they no longer want to share or take the risk because there is no second chance.

If one of our member firms was sued by a claimant on a product liability situation, or had a situation that involved an accident, the type of lawsuits that are brought to distributors, such as ourselves, are so great and so large, that the company, as it is set up right now, could never recover.

I think that a lot of business owners are just willing to take that kind of risk, you know, based on their 25- or 30-year history of building that business to what it is today.

Mr. PRICE. Finally, let me just go back to the question of how this "captive" insurance company functions.

You have described briefly for us the operations of WESCAP and you have suggested, I believe, that it has been able to guarantee minimal coverage for companies in your association.

And yet, you say costs remain exorbitant and that WESCAP has not really been a satisfactory solution to the problem. Can you tell us a little more about the workings of WESCAP and what you see as its deficiencies?

Mr. RANKIN. Let me answer the second part first. The major deficiency within the WESCAP system is that it does not take into account the regionalization of each of the businesses being quoted. In terms of situations, such as in California or in North Carolina, they are all different, but we have to take it as a group. There are no individual considerations made for each one of those member firms.

And also, WESCAP only provides or only makes available to people who can afford to ante-up, if you will. If companies that go to WESCAP are not in a position to first, afford the insurance quotes that they return to them, and second, put in the minimum cash requirements, WESCAP will not even give them a price.

And, again, it is only on those minimum coverage. WESCAP does not even operate in what I call the "umbrella market" or the higher-tiered, say, from $1 million up to $5 million. They are not even active in that arena of the insurance industry, at all.

Mr. PRICE. Well, maybe the term, "captive" is a little misleading. In what sense does the association have any kind of control over WESCAP and the terms of its policies?

Mr. RANKIN. Well, the only control that I am aware of that we have, is that the association members are the officers of the corporation, and serve as directors, officers, and so forth, so that they set forth the policy and they do the negotiations with the various large insurance carriers that carry the upper limits.

But, for the most part, they are pretty much held at bay to what the bigger insurance companies are willing to do. If they are not willing to offer some kind of program to WESCAP, obviously, there is nothing that they can do and we have just been fortunate to date that we have been with one carrier, to my knowledge, throughout the whole time.

Even though it gets more expensive every year to deal with them, they have, at least, worked with us.

Mr. PRICE. My time has expired.

Thank you, Mr. Chairman.

Chairman ECKART. My colleague from Indiana, Mr. Hiler.

Mr. HILER. I thank the chairman for yielding and I appreciate his conducting this hearing today.

Mr. Rankin, while I did not have the opportunity to hear your testimony, I read it, and one of the things that I noticed in your written comments was that you mentioned that your rates had gone up fairly significantly—as you mentioned again to my colleague—over the last 5 or 6 years, and yet you have had no claims or significant claims?

Mr. Rankin. The only claims that my company has ever had with relation to insurance, has been of an automobile nature in which a fender was bent, and I am talking $750 or $1,000. We have had no cylinder of gas explode; we have not killed anyone; we have not had any large type of thing like that ever happen.

Mr. Hiler. Now, that is, I think, a major complaint of or comment that many small business people make. It is that their premiums have gone up significantly, and yet they have had no claims.

Now, the insurance industry will come back and say, well, it may be that an individual business has not had a specific claim, but with insurance, you are spreading the risk among a number of businesses in the same kind of classification, a risk classification, and others have had those kinds of claims.

In your industry are you aware of lots of claims being filed in your type of business?

Mr. Rankin. I think that it is a very small percentage, particularly of the members of WESCAP. Surely there have been some, but in terms of the amount of moneys that have been paid in, it far exceeds the amount of moneys that have been paid out in claims, in my opinion.

Mr. Hiler. Mr. Debevc, you mentioned that your rates had gone from around $4,000 to $13,000, and if you had had comparable insurance, it might have gone to as much as $20,000 or more.

If it is not privileged information, or if it is, maybe you could give some rough approximations, what percent of your sales dollar or of your general operating expense would that be?

Mr. Debevc. That represents, for example, we figure our profit to be around 20 percent and so that is a $9,000 increase right there.

So, it is roughly $45,000 in increase sales, that is, our total we average about $750,000 in sales and it is about a 6-percent increase in sales just to cover the cost of that insurance.

Plus, the exposure level is much greater than what we had before, and I am not including in that, our specialty which was previously covered also and our special events. None of that is covered.

Also, our deductibility. Fortunately, I guess, when you don't have that coverage, you become very, very cautious, and it affects your whole business approach. You don't do things that are questionable, that you would like to try.

Mr. Griffith brought that out—I do not know how many new products he has brought out, but, I mean that greatly curtails the numbers of new products but your competition, especially foreign competition, comes out with all kinds of new products and ideas, simply because they just do not have that exposure.

So, it is really difficult for you to be competitive.

Mr. Hiler. One of the things that I think that the industry has said is the crisis has passed and there is plenty of insurance out there now, and the degree of price increases in the future should be slower, and I think that the industry says that in judging what they think the claims are going to be, and the interest rates, and all sorts of things that they use to determine the rates.

Now, I wonder, do you think that you are going to have enough—the three of you might comment on this—enough increase in your sales over the next few years, that your overall business financial structure will catch up with what has occurred in this particular cost item in the last 4 or 5 years?

Mr. DEBEVC. Since I have the microphone I will respond to that. I think that the problem is that our cost of product has gone up. And that has put us in a noncompetitive position with, especially, foreign products right now, so that is not going to change until we get a reduction or savings somewhere.

It is very, very difficult to cap additional business when you are in that position of losing sales.

I think that one of the problems that we have had in the insurance industry is that we had extremely low costs for a number of years, granted, but the insurance companies are at fault in many respects because they were grabbing that cheap dollar; they were reinvesting it because of the very high interest rates and basically their cash reserves went very, very low, because they were not charging sufficiently to cover their outlay during that period of time.

Then what happened is that the interest rates went extremely low and their return for their investment went down and they could not cover their outlay, their suits, to cover their suits. Their cash reserves got very low and you have to have a certain amount by the Federal Government, so that they are trying to build up these cash reserves by exorbitant rates, and that is why they do not reflect the losses—they are just trying to build up their cash reserves right now.

Now, they have charged exorbitant rates for a couple of years, and their cash reserves are coming back, into line, and so, they are starting to moderate, I think, and the rates are moderating, and I think that the availability is going to moderate.

However, the problem is that nothing has been changed. There is no reason why this cannot happen again, in another 2 or 3 years. It puts us in a position as businessmen of not knowing whether insurance will be available down the road, or what our exposure is going to be and our coverage that we will be able to get for that.

I think that now is the time—we saw what can happen and will likely probably happen again in the future—that there should be some reform, especially in these exposure areas that we have no control over. I think that something should be done about it now.

Mr. HILER. Mr. Griffith?

Mr. GRIFFITH. Thank you.

I would like to make an observation in answer to your question of whether or not sales will increase to the point of making up or earning additional profits to justify the expenditure.

In my case, it is which comes first, the chicken or the egg? I have observed an inverse relationship, between the availability of insurance, the cost of insurance, and sales.

What has happened to me personally, I have lost two major accounts because of my inability to obtain insurance. In my case, it is not so much the affordability, which is bad enough, but the availability, because of the peculiar nature of my business. The ethnic hair care segment of the personal care product industry is relatively new and because of ignorance on the one hand and probably, because of some prejudice again, on the other hand, most major carriers are reluctant to insure or reinsure ethnic hair care manufacturer's operations.

Lloyds of London, for example, pulled out of the market altogether.

Getting back to the question of cost and benefit, on sales, what is happening is that the smaller companies have been unable to get this coverage and, as a result, are losing business. I, personally, have lost two accounts and missed out on getting two new accounts, who agreed to take in my product line, but when they discovered that I did not have product liability insurance, they just withdrew their acceptance.

So, it is a problem that is continuously being compounded.

I am losing sales because of not having coverage, and not able to increase my sales to afford the increased premiums because of not having coverage.

So, it is a revolving dilemma.

Mr. **Hiler**. Mr. Chairman, I might just summarize and return my time to you by saying that it seems that one of the strengths of the American enterprise system has been the concept that you could have limited liability under most of our corporate structures and most of our business laws, and, at the same time, that liability that you had, you were able to join with others, pool that risk, and diversify that risk.

When you hinder the ability to do either one of those two things, either to limit your liability or to spread that risk, you really impact on what has been a strength in our economy and that is that we have 15 million small businesses.

If you impact on their ability to do those two things, individuals cannot take the risk—a family business with 10 employees, or 50 employees, or 100 employees cannot absorb the risk that the deep pocket syndrome will impose on them.

This is a tremendous problem, and the fact that we may be getting a breather from the rate of increases and there may be greater availability, does not change the fact that a lot of folks have been left lying along the side of the road because of this. I think the time for some structural reform has come, and I yield back.

Chairman **Eckart**. Thank you.

Mr. Griffith, do I understand you to say that because you are going bare you have several stores who would not take your product and put it on the shelf?

Mr. **Griffith**. Yes; very definitely.

And those are the major stores. Those are really the accounts that matter. The smaller stores are more or less indifferent toward product liability coverage. Maybe because they, themselves, feel that they don't have deep pockets and they don't have much to lose, so I can still maintain my business with the smaller accounts.

But the major chain stores, the national chain stores—I don't want to call names—they are the ones that are very insistent on getting, on being protected.

I have made an offer to sign hold harmless agreements for them, but there again, they look at that and say, well, here you are a small manufacturer and here I am a multi-billion dollar company and the complaining litigant would not go after you, they would come after me, and that is the thinking.

So, to repeat it is a revolving dilemma. How do you get out from that trap?

Chairman **Eckart**. Well, this is the fifth hearing that I have participated in that I have heard that aspect of it, that you cannot get your product to marketplace because you cannot, as a manufacturer/distributor, hold an insurance policy as a retailer and thus, you are denied access to the marketplace.

Mr. **Griffith**. Indeed.

Chairman **Eckart**. Mr. Debevc, have you experienced that as well?

Mr. **Debevc**. Well, in our particular manufacture, we don't buy, but there are similar examples. For example, we have these specialty things, these functions during the summer, and hot air balloons, and so forth, and we have had model airplane shows, and so forth, and we will not have a hot air balloon individual come in without proof that they have insurance and that we are named as secondary insured, simply because of that reason, our insurance companies require that. That is a big requirement for our insurance companies, that unless we are named a secondary insured, they will not cover us.

And so, I can sympathize very much with that. That is typical now of the industry—if you do not have insurance, you don't do business.

Chairman **Eckart**. I thank the panel for all of your observations and I am very appreciative of your being with us.

The next panel is Mr. Leslie Cheek, vice president, representing Crum & Forster, on behalf of the American Insurance Association, and Mr. John Motley, director, Federal Government Relations, from the National Federation of Independent Business, a sticker that I see on thousands of doors and windows all around my district.

TESTIMONY OF LESLIE CHEEK III, SENIOR VICE PRESIDENT, FEDERAL AFFAIRS, CRUM & FORSTER INSURANCE COMPANIES, ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Mr. **Cheek**. Good morning, Mr. Chairman. Do you want us to proceed in the order in which you mentioned us, or do you want John to go first?

Chairman **Eckart**. Well, not having flipped a coin let me proceed alphabetically then, Mr. Cheek, and ask you to proceed first. Your entire written statement will be made a part of the record.

Mr. **Cheek**. I understand that and I thank you.

I know that the issues before the subcommittee this morning are not tonsorial, but I would like to comment on the disappearance of the chairman's beard. It is most becoming.

Chairman **Eckart**. I could not get an insurance policy to keep it.

Mr. **Cheek**. Since you have indicated that our prepared statement will be included in its entirety in the record, I would like to skip over those portions of it that deal with the background of the insurance crisis and with the steps that the industry, its regulators, and State legislatures have been taking to resolve that crisis and prevent its recurrence, and focus instead on what we believe the Congress should and should not do in response to its constituents' complaints about the difficulty of obtaining and paying for liability insurance.

The depth and the length of the most recent down-cycle in the property-casualty business have forced the industry to reevaluate its approach to the measurement and pricing of liability risks. Underwriting and actuarial discipline are the current watchwords in most companies as the market gradually recovers.

Some companies decided in the aftermath of the price war that they do not wish to compete in certain lines and classifications of business. Those that remain in these lines are being far more rigorous in their evaluation of individual risk exposure and are charging prices that reflect careful analysis of the risk/loss potential.

It is no coincidence that the lines and the classes in which availability and affordability problems persist are those with the worst historical loss and expense experience and/or those in which the relevant legal standards—product liability being an excellent example—are unclear.

The rash of insolvencies that was precipitated by the price war has greatly heightened insurers' sensitivity to the need for reserve and surplus strengthening. And the improved results that we foresee in the coming 2 years should enable us to enter the next tilting of this supply and demand seesaw with healthy balance sheets and a commitment to keeping them healthy, through retention of pricing and underwriting discipline.

I would observe that all past insurance cycles, and we have been living with these now for about 60 years, have corrected themselves without Congressional interference. There is every indication that the most recent crisis is well on its way to resolution.

It is our firm belief that the best thing that the Congress can do about the crisis is to sit back and watch the competitive market work its magic again.

Notwithstanding our belief that the best action at this point is inaction, there appears to be widespread belief in Congress, encouraged by those who would subject this business to Federal regulation, that the infamous cycle of the property casualty market can be tamed through the enactment of a package of so-called insurance reforms.

Never mind that we, as an industry, have found it impossible to even out these sine curves of prosperity and poverty; never mind that the availability of liability insurance and profitability of the industry are largely determined by forces external to our business and beyond its control. The industry's critics believe they have all the answers, and a Congress frustrated by constituent complaints about insurance appears eager to buy them.

I can assure you that none of the legislative panaceas before Congress today will make one iota of difference in either the timing or the severity of the next turn of the insurance cycle. Short of nationalizing the entire insurance business, modulating and stabilizing international monetary flows, regulating prices and yields in the stock and bond markets, requiring similar rates of return among all industries, and codifying the common law of torts and insurance contract interpretation, there is nothing that Congress either can or should do that will either make liability insurance cheaper or more plentiful or prevent future insurance cycles.

The current favorite among the legislative panaceas is repeal or modification of the limited antitrust exemption conferred by the Congress on joint industry activities regulated by State law under the McCarran-Ferguson Act of 1945.

Some of the industry's critics disingenuously argue that the McCarran-Ferguson Act permits the industry to fix prices, notwithstanding the act's clear statement that the antitrust laws do apply to any potentially anticompetitive conduct that is not regulated by the States. All of the States provide for the regulation of insurance rates, but none for the regulation of price fixing, which is, therefore, plainly subject to antitrust prosecution under the act.

The proponents of the act's repeal apparently want the best of both worlds—continued pervasive State regulation, or dual Federal/State regulation, and open-ended antitrust exposure for any collective conduct that either the FTC, the Justice Department, or the plaintiffs' antitrust bar finds offensive to competition.

If the goal of the act's repeal, as the NFIB contends, is to "end intrusion in the free economy by the Federal Government," and to "set the parameters for competition," then logically, repeal should be accompanied by an affirmative preclusion of either State or Federal regulation.

But the proponents say that that is not the goal, that there should continue to be State regulation. But then if the goal is not what the proponents say it is, then what is it?

What does the industry do collectively that the Congress finds offensive to procompetition policy? It seems to us that the burden is upon those who would change the status quo to come forward with examples to prove, using NFIB's words again, that, "the antitrust exemption hinders competition."

Another favorite panacea is forced Federal insurance data collection. The State statute books are already littered with similar requirements dating from as far back as the mid-1970's. They have been of zero value, even to those who originally advocated them and they have served only to increase the cost of insurance to those who buy it, and to burden regulators with yet more paper.

Data collection might make some sense if the Congress were willing to make significant changes in the common law of torts and insurance contract interpretation. Insurance data, over time, might provide some indication of the effectiveness of these initiatives. But the Congress shows no indication that it is willing to confront the vagaries in our legal system that are gradually rendering insurer's past loss and expense experience both useless for rate making purposes and pointless for public policy purposes.

Under current circumstances, our data can tell you where we have been in the past, but so long as judges remain free to change the common law of torts or reinterpret our contracts on a daily case-by-case basis, that data will give you no clue as to where we are going in the future.

Finally, there are those who, either out of ignorance or guile, will tell you, for example, that "many insurers do not base rates on previous loss experience for smaller businesses which may penalize small firms with a healthy claim history"—or that the solution to the problem of the high cost of medical malpractice insurance for high-risk specialists is to make low-risk practitioners subsidize them—thereby suggesting that the Congress ought to put the Federal Government into the business of reclassifying commercial and professional liability insurance risks.

Insurance of all but the very largest risks requires the grouping or classification of businesses, governmental entities, and professionals with similar exposure to the insured perils, so that each of the many risks in a given classification pays only a small portion of the losses that a predictable minority will incur. It is simply not possible to predict in advance which of the hundreds or even thousands of risks in a classification will or will not incur loss in a particular year.

Thus, if the loss experience of the class as a whole deteriorates, all of its members, not just those with losses, must share the burden of increased premiums.

We thank you for this opportunity to appear before you and we would be pleased to answer any questions you might have.

[Mr. Cheek's prepared statement, with attachments, may be found in the appendix.]

TESTIMONY OF JOHN MOTLEY, DIRECTOR, FEDERAL GOVERNMENTAL RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS [NFIB]

Mr. MOTLEY. Thank you, Mr. Chairman.

My name is John Motley, and I am the director of Federal Governmental Relations for the National Federation of Independent Business, and on behalf of our 500,000 members, coast-to-coast and 26,000 members in the State of Ohio, I want to thank you very, very much for holding these hearings on the liability insurance crisis, which is, from our perspective, probably the biggest problem that has faced the small business community in America over the last 2 to 3 years.

I would like to submit my full testimony and attachments for the record, and summarize it for the subcommittee, if I can.

Chairman ECKART. Absolutely.

Mr. MOTLEY. Thank you, Mr. Chairman.

First of all, let me spend just a few minutes trying to detail for you, from our perspective, what the extent of this problem has been. Of course, we could probably go on for quite some time, but I think that maybe just a few of the facts that we have shared with other committees might be appropriate here.

First of all, NFIB publishes a survey, a study of the small business community, which it calls, "Problems and Priorities." It is a very simple study. We take 75 of the most important problems, supposedly, that people believe small business faces in America today, and we ask our membership, a randomly statistically selected, a valid sample, to tell us what they think their problems are, to pick and choose or prioritize them.

The liability insurance crisis or the cost and availability of liability insurance came out second of the 75 choices in the 1986 study. It was picked as the most critical problem facing their business by 38 percent of the respondents. This of course, was verified for all of you by the recommendations of the White House Conference on Small Business last August, which the No. 1 recommendation was a rather extensive recommendation dealing with the liability crisis in general, voted for by 1,419 of the 1,715 delegates who attended, or 83 percent.

In fact, the problem was so great that the number nine recommendation of the conference dealt specifically with product liability problems.

We hear rumors that the crisis is abating, that availability is going up and that indeed, the small business community's problems with the availability and cost of liability insurance is easing. Well, NFIB also runs a continuous field survey. We survey when we renew our 500,000 members every year. The representatives carry a survey with them and we ask a series of questions and those questions are changed quarterly.

I might add also that we interview about 6,000 small business owners a day.

In the most recent quarter, we asked several questions on liability insurance, cost and availability, and 44 percent of those responding indicated that it was still the most important problem facing their business, by and far the single most important problem. Of those who responded, 42 percent indicated that in the last year, their insurance liability premiums had gone up over 50 percent.

So, I would say to you, and this is from the first quarter of 1987, that the problem is not abating for many, many small business owners across the country.

Of course, this is backed up by the tens of thousands of telephone calls and pieces of mail that we have all gotten over the years.

Let me, if I can, Mr. Chairman, give you one example that I just heard the other day for the first time, from a Cleveland area firm, manufacturer of durable goods, a firm that I believe that you know fairly well.

In 1984, this firm had coverage of $200 million in liability insurance at a cost of $400,000, per year. In 1985, their coverage dropped to $85 million for the price of $1.8 million for the cost. In 1986 their coverage went up to $125 million with $50 million of that being self-insured at a cost of $3.8 million in insurance.

This is a rather significant example of the increase in costs that many of these firms across the country tend to experience. The liability insurance crisis is a very, very complex problem from our standpoint.

When we first began to hear about this, we sat down with representatives of the insurance industry, and with representatives of those who consumed the product, and tried to come up with some idea of what was happening in the industry.

And from that investigation we came up with what we believe to be three causes for the problem that the small business community has faced.

No. 1, we are convinced that the civil justice system is in need of reform. No. 2, we are also concerned that there is a very patchwork quilt of haphazard State regulations, which basically allows the insurance industry to operate in almost any way that it wants, across the country.

No. 3, the business practices of the insurance industry, itself, we think, are, at least partially to blame for what has happened.

It is a complex problem, as I said, and there are no easy solutions As all of you know, NFIB sets its positions by membership vote. Over the last couple of years, we have polled many, many different solutions—almost all of those that have been suggested by either anybody here in Washington, or across the country.

We believe that our members have a fairly good idea of what may be needed, and their votes kind of reflect this. They have voted 81 percent in favor of comprehensive tort reform; they have voted 65 percent in favor of a national product liability law; and I might add here, that that is after twice voting against the law, because they did not want the Federal Government involved, they wanted to keep it at the State level.

But of course, we have a decade-long crisis which has been unsolved and therefore, they feel that other action is probably needed.

They have voted 60 percent in favor of repealing the antitrust exemption, the limited antitrust exemption, which is in the McCarran-Ferguson law. I might also add here, very quickly, that they are still convinced that the Federal Government will not do as good a job regulating the insurance industry as the States, and they have voted two-thirds against transferring that responsibility.

Let me look at each of the areas that I outlined before, and at the solutions that we think, should be, at least considered.

In the area of State-regulation, NFIB is working with a number of other trade associations, the insurance industry, and anyone else interested in the crisis to try to come up with reforms and to eliminate some of the abuses that occurred at the beginning of the recent crisis. But I am afraid that we feel that this may not be enough.

That, in fact, what may be needed out there, is a much more uniform climate of State regulation of the industry. As far as tort reform is concerned, and we believe that there is an urgent need for reform, we must return to a fault-base system and also to eliminate joint and several liability.

I do not think that we can say it any more eloquently than the small business people who appeared here on the panel just before we did.

NFIB is supporting legislation which is already under consideration by your other committee, Mr. Chairman, and that is H.R. 1115, introduced by Congressman Richardson and Congressman Luken, coming up with a national product liability tort reform bill.

There is only one section of that bill that we have some concerns about and that is the section which would eliminate the employer's subrogation lien. We would like to have the committee, as it proceeds, to take a look at the impact of that action upon small employers across the country.

This solution, H.R. 1115, it is true, only deals with product liability and not with broad general liability which was some of the problem, again, discussed by the previous panel.

But NFIB is supporting it because we believe that if the Congress were to go ahead and enact a uniform product liability law, that it would approve a good model law, or a good example for future

State action, we could bring some uniformity to what is happening out there in the regulatory area.

Third, as far as the insurance industry is concerned, again, let me state for the record, that our members would be opposed to Federal regulation of the insurance industry. But they do support repeal of the limited antitrust exemption which is contained in the McCarran-Ferguson Act.

Congressman Don Edwards has begun hearings in the Judiciary Committee, on this, and NFIB is certainly supporting his continued investigation. In terms of the one comment made by my colleague, Mr. Cheek, the difference here is that we do not believe that the burden rests upon those who wish to change the status quo, but we believe that the burden of proof rests upon an industry to prove that it needs a continued exemption from what is the current law of the land.

In the area of insurance regulation, again, Mr. Chairman, NFIB is currently polling, allowing the FTC to investigate the insurance industry, which it has been prohibited from doing since the early 1980's. Our preliminary results of that poll, 35,000 members responding, 68 percent are voting in favor of lifting that prohibition against the FTC, and suggesting that they take a look at what is happening in the insurance industry today in terms of the liability crisis.

In conclusion let me say, Mr. Chairman, that it is my fervent hope and the hope of most small business people that I have talked to, that these hearings, which have been begun by you at the subcommittee level, and by the chairman of the full committee, are just the beginning of the Small Business Committee's involvement in this particular issue.

We would urge the committee to assist the small business community in pursuing all of the solutions that may be out there and needed to this crisis. We would urge you, particularly, to work with Chairman Dingell, and with your colleagues on the Energy and Commerce Committee, to try to come up with a product liability bill that can be enacted by the House some time this year.

We would also urge you to work with Chairman Edwards in the Judiciary Committee to continue his investigation of what should be done with the McCarran-Ferguson law, and in particular, the antitrust exemption.

And last, but not least, we would hope that you would continue to look at the wide discrepancy in State regulation of the insurance industry, and maybe come up with some suggestions that have eluded the rest of us who are taking a look at this problem for some way that we can come up with, and very possibly suggest a more uniform climate, so that not only the insurance industry knows what it is dealing with across the country, but also something that the small business community can live with.

Thank you, Mr. Chairman.

[Mr. Motley's prepared statement, with attachment, may be found in the appendix.]

Chairman Eckart. Mr. Price.

Mr. Price. Thank you, Mr. Chairman.

Mr. Cheek, I wonder if you could elaborate on one aspect of your testimony. On page 21, you state that it is no coincidence that the lines and classes in which availability and affordability problems persist are those with the worst loss and expense experience and/or those for which the relevant legal standards are unclear.

Yet, we have heard testimony this morning and in previous hearings that the problem is widespread and applies to a wide range of businesses and to a wide range of experience ratings. Could you tell us on what your rather broad generalization is based?

Mr. CHEEK. The principal line that is troubling for us is what is called the general liability line. The general liability line includes a number of classes, which number approximately, I believe, 1,400 in the ISO Commercial Statistical Plan.

And these would include everything from voluntary association boards to the largest corporations. Eleven hundred of these categories include different kinds of product manufacturers.

What we have found is that in particular classes of the general liability book of business—for example, directors and officers liability, certain categories of product liability, and municipal liability—the losses and expenses have simply outstripped our capacity to keep up with them.

Many underwriters' response to that situation is to say, "I have lost the handle and therefore, I am not going to make a market any longer in those lines." Broadly speaking, the talk that we have heard recently of a litigation explosion, is not, I think, uniformly true across all lines of insurance, but is confined primarily to what I would call trendy fields of tort litigation.

A good example would be, for example, the suits that the FDIC and the FSLIC bring against the boards of directors of banks and savings and loans that they are forced to go in and bail out.

When we wrote contracts for these boards years ago, we had no idea that we would end up defending our insureds, against suits by the Federal Government for amounts that they have put in to bail out the banks.

It is that kind of unanticipated exposure that has, in that particular class of business, for example, driven the losses and expenses to the point where many companies have simply decided that they are just no longer willing to make a market.

Mr. PRICE. Are there studies or collections of data which will bear that out?

Mr. CHEEK. Oh, yes; sure.

Mr. PRICE. To the satisfaction of an objective observer?

Mr. CHEEK. I would think so.

The ISO put out for the Congress, I think a year ago this month, is a very comprehensive package that looked at, for example, municipal liability by the size of the town, zero to 50,000 population, 50,000 to 100,000, and so forth, and so on, and even subdivided that into, for example, municipal streets and highways, showing you the premiums that had been collected in a given year, and the losses incurred, in those years.

And just to pick the municipal streets and highways example, losses and expenses were five times what premiums were. That is a loss ratio that no insurer can withstand for long.

Mr. PRICE. Let me shift the focus, just for a moment, since my time is limited.

Mr. Cheek, I would like to ask you to respond to one particular aspect of Mr. Motley's testimony. He has said that, ideally, he would not favor a Federal regulation of the insurance industry.

Mr. CHEEK. We appreciate that.

Mr. PRICE. However, he also lists a series of serious problems that small businesses have encountered with the insurance industry. I would just like to ask you to respond to the list on page 15 of Mr. Motley's testimony: The problem of short notification periods, the problem that claims history seems to have no bearing on an insurer's decision to cancel, and the problem of industrywide cancellation—I know that is a long list and involves some rather detailed problems, but I wonder if you could give us a general indication of industry responsiveness in these areas?

Mr. CHEEK. I would be glad to, Congressman.

The point that John raises there is an entirely legitimate one. What happened at the end of 1984 when insurers looked at their bottom line and saw that they were under water, was rather like what happens in a newspaper office when a reporter turns in a story that is too long for the space assigned to it, you just simply lop off the final few paragraphs.

What most companies did was to take a look at their whole book of liability insurance business and to get rid of those or bail out of those that were giving them the most trouble in terms of either the lack of predictability or the size of the losses.

What that kind of class underwriting, if you will, produced, was widespread unavailability in certain classes of business. Many carriers responded with, for example, midterm cancellations or midterm premium increases, or nonrenewals of entire books of business without explanation.

There was an element of panic there that I think was certainly justifiable for some companies, but as a market conduct phenomenon, was as unacceptable to our regulators as it was to the business as a whole.

What most of the States did, in many instances with our support and cooperation, was to apply to the commercial insurance business, which historically has been fairly deregulated, some of the market conduct restrictions that have historically been applicable to the so-called personal lines of insurance.

Those restrictions would include, for example, a requirement that we give 30 or 60 days' notice before we are going to either nonrenew or cancel a particular policy, and prohibitions against midterm premium increases so that people will know at the beginning of the year that the price that they have paid will stick for the whole year.

Similarly, we have supported reasonable restrictions on notice as to nonrenewal and notice as to the price increases that will attend a renewal of these policies.

We believe that restrictions of this nature are necessary to help our insureds find coverage in other markets if we are unwilling, as individual companies, to renew that coverage.

Mr. PRICE. Mr. Motley, do you have any comments either on your specific suggestions or your general points about insurance? I am particularly interested in the persistance of availability and affordability problems for small businesses and the relevance or irrelevance of their experience ratings.

Mr. **Motley**. The only thing that I could comment on, Mr. Price, would be that the experience that we have had with it, in terms of the complaints that we have received from the membership, which I think is borne out by taking a look at the type of people who were delegates to the White House Conference on Small Business, is that the problem does seem to be broader and deeper in terms of the types of businesses that are being affected by the crisis, than the industry seems to indicate.

They say that it is in certain high-risk lines and certain categories of underwriting and to us, it certainly appears much broader.

All the way from the retail establishment on Main Street, to resorts, and of course, the types of businesses that you would expect, auto repair, body shops, and things like that which are fairly high-risk, in nature. But it does not seem like there were many types of businesses which escaped the types of circumstances which occurred at the beginning of the crisis—midterm cancellations, rate increases, difficulty in finding insurance, and all of the other lists of things that have been discussed here.

Again, we would be more than happy, I think, as we have done with both the GAO and with some of the Senate committees, to have the committee take a look at all of the correspondence that we have received over the last couple of years in response to this.

I think that the general pattern that I just outlined, would become very, very obvious very quickly.

Mr. **Price**. Thank you, Mr. Chairman.

Chairman **Eckart**. Mr. Hiler.

Mr. **Hiler**. I thank the chairman.

Mr. Cheek, would you say that looking at my two colleagues and me up here that we would be pretty high-risk individuals?

Mr. **Cheek**. For what exposure, Mr. Hiler?

Mr. **Hiler**. Well, you are in the insurance business.

Mr. **Cheek**. Well, we write all kinds of insurance. If you were say a lawyer——

Mr. **Hiler**. No, no; we are Congressmen.

Mr. **Cheek**. Right. As far as I know, because you are Federal officials, you fall under the shelter of the Federal Tort Claims Act.

You would be good risks.

Mr. **Hiler**. We have both been canceled on insurance.

Mr. **Cheek**. For what?

Mr. **Hiler**. For umbrella policies, in case we were ever sued on something just to try to protect ourselves. He has been canceled and I have been canceled.

Mr. **Cheek**. Then we must all fall into the same category, be cause I was turned down for umbrella coverage.

Mr. **Hiler**. I guess the reason that I asked that is because I think that one of the things, and I think that it is an area that—and believe me, I am not bashing insurance companies—but one of the things where I think that the insurance industry is having a credibility problem is in this whole 1,400 classifications of industries and businesses and risks.

We have looked at those all very carefully and the rates have only gone up where the claims have gone up and/or where the risk factor, the exposure factor has been higher.

I think that a lot of people just plain do not believe that. And they think that the three people that we had up here before, do not believe it, and I do not know whether you have had a lot of Congressmen that you have had to pay—the insurance industry has had to pay a lot of claims on umbrella policies, but he was called a celebrity and that is why he could not—maybe if we got paid like Paul Newman we would be willing not to take the insurance, right, Mr. Chairman?

Mr. CHEEK. If I could, I would like to comment, just briefly, on the question of the umbrella policies.

We are the major writer of umbrella business in the United States. Our big problem is capacity. Our reinsurance arrangements just dried up. And as much as we would have liked to have written your policies, and I do not know if we had your business or not, part of the problem that we have had is a capacity problem, in that even if we wanted to write the business, we could not, because of the capacity problem.

For example, we had 3-year contracts in effect at the beginning of 1985, for directors and officers liability. Our reinsurance capacity went from $10 million to zero and we had to write every one of our policy holders and tell them that from henceforth, all that we could offer them was $1 million in coverage instead of $10 million, and we had to retain all of that risk for our own account. We had no reinsurance.

So, part of the problem that your carriers may have been having is a problem with capacity, rather than an assessment of the risk that you or the chairman might pose.

Mr. HILER. Well, we are pretty risky individuals, I know that.

But one of the things, and this is maybe, a subjective thing that you may or may not have a detailed answer on, but how can insurance in the United States be obtained at affordable rates, and not have the increases and all of those kinds of things? How is it different than what we might find in other western industrialized countries and why do you think that those differences exist, if there are differences?

Mr. CHEEK. I think that there are several points that you could take here. For one thing, most other industrial countries have a fairly pervasive system of health and income support, as a matter of public policy.

We do not. We do not have a guaranteed wage; we do not have an all-encompassing national health insurance program. And as a result, the tort system here is often turned to, as a kind of court of last resort, if you will, for the replacement of income loss and the payment of medical expenses.

When you consider the sort of force that is driving lawsuits and then relate it to our legal system, our legal system differs dramatically from that in most other countries. We are the only nation in the world that allows a contingency fee system. We are the only nation in the world that places no limits, whatsoever, on the amount that one can recover. We are unique in our system of punitive damages.

We are unique in giving every litigant the right to a jury trial, as opposed to a trial before a judge. I think that we also are one of the few nations in which the law is shaped entirely on a case-by-case basis, as opposed to black letter law in a statute book.

Those are just a few of the differences that, I think, explain the extraordinary difference in the cost in insurance here and the cost of insurance in other countries.

Mr. HILER. Do you think that there are ways through tort reform, and what not, that we can reform some of these areas to not duplicate the system in other countries but at least bring a greater degree of reason to our system?

Mr. CHEEK. I think so.

Most torts, or individual wrongs, of course, are local, in that they occur in a single State, and it would seem to me that in all of the areas of tort law, except product liability, where products move back and forth among the States, that the States are the most appropriate forum for change.

It would seem to me, though, in the products liability area, as John and the other witnesses this morning have testified, some degree of Federal action is necessary to assure that wherever the product moves in interstate commerce, the rules are always the same.

From our standpoint as insurers, we do not need the pervasive tort reform that has been talked about in the States during the past couple of years. There are a relative handful of things that we need to restore our ability to predict risk, and the big question is how much is society willing to pay for the predictability of those rules?

In other words, if you put caps, for example, on pain and suffering recoveries, and let us say that the cap chosen is $250,000, if you are an insurer that writes policies that do not have a limit of any more than $250,000, caps do not do a thing for you. But, by the same token, if you change the rule of joint and several liability, so that the price that you have assessed the risk at is going to stick every time, no matter whether that risk is the only deep pocket in a given situation, that would be very helpful to us.

I think the reforms that we would pick as key in the product liability area would be joint and several liability; some recognition of the state-of-the-art as far as product warnings and design defects are concerned; some treatment of the collateral source rule, so that litigants are required to recognize in their suits the fact that they have been paid for some or all of the losses for which they are suing.

I think that some rationalization of the interaction between workers' compensation and product liability law would be helpful, and I think that it would also be excellent to have a fault standard for product sellers, so that the wholesalers and the retailers of this world are not dragged, at great expense, into litigation in which the fault lies with the product manufacturer.

Mr. HILER. OK.

John do you have any exceptions to anything that Mr. Cheek mentioned?

Mr. MOTLEY. No; I really do not, Congressman Hiler. I think that you will find that the business community is almost unanimous in its support for the types of reforms and changes that Les has mentioned.

And, I guess, really the problem is a matter of one of frustration, of not having been able to deal with it, before now. We are more than a decade into this product liability crisis. Small businesses and large businesses have had to deal with it, and have been unable to deal with it in many instances.

I think that is really shown by the significant change in opinion in NFIB members over the last 10 to 12 years. I mean they voted 2/3 against a Federal product liability law, just 8 or 9 years ago and now they are voting more than 2/3 in favor of it.

Why? Because it cannot be done dealing with 50 separate sets of State laws, when it is something that is dealing with interstate commerce.

Mr. HILER. I just have one last question, Mr. Chairman, and I would ask for a subjective opinion from you, John.

NFIB represents a lot of different kinds of businesses. You have retailers, restaurant owners, barkeeps, and you have got some of everybody.

And insurance, certainly if you have a restaurant with a lounge there, where drinks are served and you have had your insurance go up dramatically and it puts you out of business, obviously that is a very severe problem.

But it seems to me that we run the risk in the manufacturing side of the economy, particularly those manufacturers that are heavily involved in research and development, with the inability to get insurance and have adequate insurance, that we run the risk of taking what has been one of the strengths of the small business community, which is coming up with new inventions and new ways of doing things, and really stifle that entrepreneurship, because the risks become so high for it.

Mr. MOTLEY. They will not even try. If you assess the situation, as again, the panel before us stated so eloquently, in simply trying to bring rather simple products to market, and you are stymied by the situation in the liability insurance area, you are not even going to bother to try. You are just going to bag it and what you are going to end up doing is fooling around for your own pleasure and enjoyment and not really becoming an entrepreneur.

Entrepreneurs have to face so many problems, financing, putting their future on the line, all of those types of things, and the one thing that they had that was fairly assured, up until just a few short years ago, was to be able to insure themselves against the risk, if they ran into a problem with a product in the marketplace. They do not have that any more.

I think that if you walked around during the White House Conference on Small Business, that was something that you heard constantly coming from the delegates, that many of them had new products that they wanted to take to market, and they simply could not do it because they could not get coverage, they could not protect themselves against the risk.

So, I think, the point that you are trying to make is very accurate and right on the mark and it does threaten our competitive position in the world marketplace over the next couple of decades.

And you know how concerned Congress is about that. I mean, we are going to spend the first 9 months, maybe even the first year of this Congress, dealing with trade and competitiveness type issues.

Mr. HILER. I thank you, and yield back, Mr. Chairman.

Chairman ECKART. Mr. Motley, I am trying to reconcile something here. Elimination of the McCarran-Ferguson Act gets a big number, uniform product liability gets a big number, comprehensive tort reform gets a big number, and uniformity in the system among the States, I would assume is supported as you suggest here.

But then Federal minimum standards die. How do we get there from here? Do you see what I am saying?

Mr. MOTLEY. Yes.

Chairman ECKART. When you talk about uniformity among the States and repeal of McCarran-Ferguson, or a strong endorsement of changing the FTC exemption, as mentioned on page 17 of your testimony, how do we get there from here?

Mr. MOTLEY. Well, first of all, let me say that there really is nothing except, possibly, a series of individual votes on the State level indicating that our membership would support uniformity. I mean there is no formal NFIB position.

Chairman ECKART. Right.

Mr. MOTLEY. We are suggesting that we take a look at these whole realms of problems and whole realms of solutions that are out there, as the possible solution.

I think that if you find that you have many industries which are regulated on the State level, you generally tend to have the associations of the regulators coming up with model sets of standards, minimum standards which they tend to abide by in each State, or they try to have each State enforce.

It does not appear to us that that type of situation exists in the regulation of the insurance industry. I mean, you have some States, which could, obviously, be accused of drastic over-regulation, and you have others, in which we have a law on the books and there is, basically, no regulation of what is happening in the industry.

There is no doubt that NFIB members trust the Federal Government the least when it comes down to regulating business activities in the marketplace. So how do you get from here to there?

I would hope that the crisis and all of the solutions that have been proposed which scare the industry, which scare the regulators themselves, because I think that in the testimony before the Judiciary Committee, on the repeal of the antitrust exemption, that it was, basically, the industry and the regulators who came out against the repeal of the antitrust exemption and the Justice Department, the FTC, and most of the business groups came out in favor of it, that that type of scare would at least force the regulators to sit down and try to come up with some minimum standards themselves, or a model law or something that would create some more uniformity in the way that the insurance industry is regulated on a State-by-State basis.

I do not know how we get from that to actually having them do it. I guess what I have suggested in our conclusion, is that if there is any role, that this committee or the other committees of the

House could play in fostering that type of common thinking in the area of regulation, then we would urge you to do it.

I do not know how you do that other than jawboning, cajoling, trying to bring the regulators in and saying, look, here is the situation and it simply has to get better or else Congress is going to be forced to act at some time in the future.

Chairman ECKART. The prohibition that Congress placed on the FTC in 1980, which you would like to see us——

Mr. MOTLEY. I forgot that one; yes.

Chairman ECKART [continuing]. Repeal, thus is—I mean by your definition, an appropriate level for the Federal Government to have in the review of insurance activities—without passing minimum standards.

Mr. MOTLEY. It is. I know that the people in the insurance industry are going to say that is the camel's nose under the tent, that is the first step toward Federal regulation. We already provide all of the information that the States request.

But let us face it, there are very, very few States out there, yours probably being one of them, maybe another couple of other States that have the resources, the staff, the ability to analyze that information and to come up with a very broad view of what is happening in the marketplace.

We tend to feel that the FTC along with the Department of Commerce is probably one of the few entities that are out there that could make an intelligent judgment, based upon data that was received.

We did not support the limited doing away with that exemption when it was on the Senate floor, by Senator Metzenbaum, just 3 or 4 weeks ago, because we had no indication that the membership would support that. The poll results that I gave you have just come in, in the last 10 days, so that we would now be shifting our position and saying, yes; let us let the FTC investigate the insurance industry.

If you get Dan Oliver up here and you talk to him and you ask him the question of what is going on in the industry, he will give you one answer and he will give it to you until you are bored to tears, and that is, I do not know because the FTC is prohibited from taking a look at the industry.

I do not know because we are prohibited. We feel that to have an entity like the FTC, with the type of resources that it has available to analyze the situation, to simply take a look at the industry and try to come up with some suggestion as to what is happening nationwide, not on a State-by-State basis, is not a terribly damaging intrusion into the State regulation of the insurance industry.

Chairman ECKART. Mr. Cheek, do you agree, disagree, or protest violently?

Mr. CHEEK. No; let me answer first the how do you get from here to there question and then deal briefly with the FTC.

One of the things that I think should be remembered is that in the personal lines insurance business, historically, as you know from your service in the Ohio Legislature, the legislatures have been very sensitive to the unequal bargaining power between policy holders and insurance companies, and have laced the statute books with restrictions on cancellation, restrictions on nonrenewal, and so forth, and so on. Those same kinds of restrictions, historically, just simply were not present in the commercial insurance business, mainly because up until this most recent crisis, the personal lines, rather than the commercial lines, were the fundamental problem.

The States did not feel a need to respond in the past, so what you have, in effect, is a new phenomenon, in which the problems are in the commercial sector of the business rather than personal.

I think actually, considering the very short time in which the States have had to move, that the pace of change has been pretty remarkable.

You have 13 States that, last year, gave the insurance commissioner authority to do in the commercial market what he has always been able to do in the personal lines market, that is, to set up residual market mechanisms, or markets of last resort for people who cannot get it through normal channels.

You had a rash of new requirements for notification on cancellation, notification on nonrenewal, and so forth, and so on.

I also have a minor difference with John on the question of what engines there are to assure uniformity. There is the National Association of Insurance Commissioners, a trade association of insurance regulators. They meet twice a year, and almost always have before them, at every meeting, a new model regulation or a new model statute, to deal with the particular problem that has bubbled to the surface.

And they have an entire book full of model laws. I would say, though, to partially agree with John, that the record of the States in enacting the model laws has been less than exemplary.

But, I think that the answer to the how we get from here to there, the uniformity question, is largely going to be a function of whether this problem persists. To the extent that it does, I would guess that most of the States will tend to adopt the same basic framework of regulation to make sure that policyholders are protected.

On the FTC issue, the amendment that the Senate crafted is a finite two-pronged approach to having the FTC study the business. One prong deals with medigap advertising and the other would take a sort of one-shot look at the rating situation in the commercial liability insurance business.

I would also say that the FTC, if it wants to study something, has to do nothing more under current law than to approach either of the two Commerce Committees and ask for their authorization to study whatever they want.

The fact that they have not, I suspect, is a function either of resources or a lack of interest up, until recently, in the insurance business, but we do not think that the FTC needs the kind of open-ended carte blanche authority that existed prior to the 1980 amendment.

Chairman ECKART. Mr. Price, Mr. Hiler, I thank both of you for attending today. We, hopefully, in this Committee and in our other Committee assignments, intend to use the information you have provided us to help shape some of our positions.

I thank you.

And there being no further business, the subcommittee stands adjourned.

[Whereupon, at 11:30 a.m. the subcommittee adjourned, subject to the call of the Chair.]

APPENDIX

Testimony of
Leslie Cheek, III
Senior Vice President-Federal Affairs
Crum & Forster Insurance Companies
on behalf of the
American Insurance Association
before the
Subcommittee on Antitrust, Impact of Deregulation & Privatization
Committee on Small Business
U.S. House of Representatives

Washington, D. C.
May 13, 1987

INTRODUCTION

Mr. Chairman and members of the Subcommittee:

The companies I represent belong to the American Insurance Association (AIA), whose 171 members write approximately 25 percent of all the property and casualty insurance sold in the United States, and the overwhelming majority of the commercial coverages that are the subject of today's hearing. I have been asked to speak on behalf of AIA as well as for my own companies.

What I will do first this morning is provide some background information on the crisis of commercial liability insurance availability and affordability that has plagued American business -- particularly small businesses -- to varying degrees for the past three years. Then I will describe what the industry, its regulators, and the State legislatures have been doing to resolve the crisis and prevent its recurrence. Finally, I will offer some recommendations as to what the Congress should -- and should not -- do in response to its constituents' complaints about the difficulty of obtaining and paying for liability insurance.

ORIGINS OF THE LIABILITY INSURANCE CRISIS

The crisis has been variously described as either a liability crisis or an insurance crisis. In our judgment, it is both, because, like it or not, liability and insurance are inextricably intertwined.

Until the mid-1970's, the cost of liability insurance rose very slowly, mirroring both the relatively low rate of inflation in our economy and the traditionally slow evolution of the common law. But then, in 1973, a Federal Circuit Court extended the concept of strict liability, first applied in 1963 to product defects,[1/] to asbestos manufacturers' failure to warn asbestos workers of the health hazards of asbestos exposure.[2/]

The Borel decision set off a revolution in the common law of torts that continues largely unabated. The key problem for insurers in this revolution is that the retroactive application of tort liability for conduct that was not tortious when it occurred[3/] requires the payment of damages under insurance contracts whose prices were based only on past experience and whose underwriters could not possibly have foreseen the economic implications of 20-20 judicial hindsight. This phenomenon is at the heart of the industry's current unwillingness to bet its policyholders' surplus on any business, professional, or governmental entity whose past or current activities pose any risk of future liability for long-latency harm.

At the heart of the common law revolution is the notion that, as between innocent injured consumers and perhaps equally innocent business, professional or governmental organizations, the latter are in a better position to absorb losses than the former, by virtue of their ability to spread costs among all the purchasers or users of their products or services by raising prices or taxes and/or purchasing liability insurance.

While this notion may make sense as a moral or societal matter, its application has utterly destroyed the ability of insurance underwriters and actuaries to measure and price the potential liability of a variety of public and private enterprises, bringing about the following Catch-22 situation:

The courts seem clearly committed to socializing the tort system by moving away from fault as the predicate for imposing liability and toward injury as the premise for awarding damages. The accelerating imposition of tort liability in the absence of wrongful conduct (and sometimes even in the absence of any injury[4/]) makes the availability of liability insurance progressively more important to potential tort defendants ranging from voluntary recreation association boards to major corporations. Meanwhile, insurance underwriters are either withdrawing entirely from certain lines and classes of business or expressing their growing uncertainty in stupendous price increases, because the bases upon which the courts are now imposing liability have rendered much past loss and expense experience useless as a measure of future costs.

Just as the higher costs spawned by the liability revolution were beginning to show up in insurers' results, a unique confluence of excess capacity, cheap and plentiful reinsurance, and spectacular returns on investment of premium income pushed the casualty insurance industry into a five-year price war. Even as liability insurance losses were growing at an annual rate of more than 15 percent, and even as liability loss adjustment expenses were in the process of doubling, the liability insurance business was propelled into a price-cutting binge totally at odds with an already apparent need for price increases and reserve and surplus strengthening.

Why did this happen? Why did prices go down when liability insurance losses and expenses were going up? The property-casualty insurance business is intensely competitive; there are more than 3,500 property-casualty insurers in the United States, of which some 900 compete in interstate commerce. At the time the price war began, the demand for liability insurance was essentially static, largely as a result of a continuing trend toward self-insurance among major businesses, while the supply of insurance (capacity) was increasing. Naturally, prices headed downward as insurers sought to maintain or increase market share.

In the early 1980's, as investment yields continued to rise and competition for premium intensified, many insurers abandoned risk-related pricing in favor of accepting actuarially inadequate front-end premiums on the theory that investment income would make up the gap between premium income and loss and expense outgo.

Through 1983, although underwriting losses continued to mount, investment income was sufficient to cover losses and expenses and produce an overall profit. But as interest rates stabilized and many foreign sources of reinsurance withdrew from the North American market, "cash-flow underwriting" abruptly collapsed. In 1984, the industry suffered a $3.8 billion operating loss and had to dip into its surplus (or operating capital) to the tune of $2 billion in order to honor its contractual commitments.

In 1985, the industry was faced with a need to increase prices in the teeth of sharply reduced reinsurance capacity, shrunken surplus, and liability insurance losses and expenses that had increased 25 percent over 1983 levels during 1984.

The shrinkage in surplus and reinsurance sharply curtailed the industry's capacity, while the need to retain superior business at higher rates forced insurers to prune less desirable risks from their portfolios. The results of this triple whammy included abrupt withdrawals of specialty carriers from such markets as day care centers and municipalities; the virtual disappearance of the pollution liability insurance business; a sudden tightening of product liability, directors and officers, and professional liability insurance markets; and, of course, dramatic rate increases.

The industry is now in the third year of bringing the prices of its products back in line with their costs. With insurance prices now at or approaching actuarial adequacy and the industry's capacity expanding as its surplus is rebuilt, most insurance availability problems are in the process of resolving themselves. And it is our judgment that the outcry over price increases will diminish as the rate of these increases falls back into line with ongoing loss and expense experience.

But even as the market as a whole gradually recovers, however, the Catch-22 situation remains: Certain lines and classifications of insurance continue to be either unavailable or available only at prohibitive cost even as demand for them increases. The shrunken markets and soaring prices in these lines are messengers of a common reality: the liabilities to which these lines are designed to respond have outstripped the ability of the insurance mechanism to predict and measure their economic consequences. Nothing proves this better than the fact that, even with double and sometimes triple-digit rate increases, aggregate loss and expense experience for liability lines in 1985 went up 43 percent over 1984's experience, which in turn was 25 percent worse than 1983's! If current liability insurance loss and expense trends continue, a policy that cost $100 in 1981 will cost $300 by the end of this decade.

To their everlasting credit, nearly three dozen States last year attempted to address those aspects of this Nation's system of civil justice that are frustrating insurers' ability to underwrite and price liability insurance for some entities subject to it, recognizing that change is needed if insurers are to continue performing their traditional risk-spreading function and insurance is to remain affordable.

Unfortunately, most of these well-meaning enactments left in place the principal State statutory and decisional impediments to the predictability of risk, and the Congress failed once again to enact desperately needed reform in its Superfund waste cleanup statute and in State product liability law.

Thus, we foresee a continuing need for further reform efforts, not to curtail the rights of victims, as some would have it, but rather to relate liability to wrongful conduct and to assure that damages bear a predictable relationship to the harm involved.

Regulatory tinkering with the insurance mechanism will not solve the Catch-22 of liability insurance: Insurers are nothing more than the legal system's middlemen, and until that system's costs are reduced, liability insurance prices can go nowhere but up.

INDUSTRY, REGULATORY AND LEGISLATIVE RESPONSE TO THE CRISIS

George Santayana must have been thinking about the property-casualty insurance business when he wrote, in 1905, that those who fail to remember the past are condemned to repeat it.

Insurers found out in the no-fault auto insurance wars of the early 1970's that the legislative *quid pro quo* for statutory curtailment of common law tort remedies is statutory restriction of insurers' underwriting and pricing freedom. Of the 16 no-fault laws ultimately enacted, nearly half contained rate rollback provisions, the depth of the cuts usually varying inversely with the extent of legal reform.

When the no-fault wars gave way to the medical malpractice crisis of 1975-76, the handful of State reform laws were so uniformly accompanied by insurance data reporting requirements as to compel the Insurance Services Office (ISO) to break medical malpractice premium and loss information out of its "liability other than auto" line.

When the medical malpractice crisis was succeeded by the product liability crisis of 1977-78, some 33 States enacted some degree of product liability reform. Eighteen of these statutes contained insurance data reporting requirements, forcing the ISO to again revamp its Commercial Statistical Plan and compelling the National Association of Insurance Commissioners (NAIC) to adopt the Product Liability Supplement to the Annual Statement.

And, finally, the price war of 1980-84 led to the general liability insurance availability and affordability crisis of 1985-86, which spawned nearly three dozen scatter-shot tort reform enactments, three rate rollback requirements, 13 residual market mechanisms, and 19 data reporting provisions. The costs of complying with these regulatory restraints will probably exceed the savings from the tort reform enactments.

The industry's failure to remember the past caused it in 1985 and 1986 to embrace a cure for its liability insurance problems that may prove worse than the disease. Its unhesitating romance with "tort reform" may do little to curb liability insurance losses and expenses, and has already invited retribution beyond the industry's wildest imaginings.

Faced with the necessity of digging itself out of the most phenomenal price inadequacy in its history, a price inadequacy that was, at least in part, a result of its own competition-driven abandonment of cost-based pricing, the industry initially failed even to acknowledge, much less to explain, its own contributions to the availability and affordability crisis. Instead, the industry chose to go on the offensive, and to lay its troubles at the doorstep of a tort law run amok.

At the State level, the industry's tort reform offensive was, like the earlier no-fault auto insurance campaign, initially successful, but later encountered the classic argument of the Association of Trial Lawyers of America that there is nothing wrong with tort law that insurance data reporting and rate rollbacks can't cure.

I do not mean to suggest that there is no need for change in certain aspects of the way our tort system operates, but the industry stepped into a trap for the unwary when it embraced, as its own, the reform agendas of others. When the industry was asked to show and explain how all the items on its early tort reform platter had affected its results, the explanations were usually incomprehensible and seldom accompanied by loss or loss expense data.

By taking the offensive without adequate thought or preparation, the industry not only deepened its credibility problem but also allowed its enemies to advance the argument that the industry and its regulators, not the law of torts, were the real cause of the crisis.

What the industry did in its enthusiasm for wholesale tort reform was to abandon its limited role as the *middleman* in America's system of civil justice, in favor of a broader role as the *arbiter* of that system. The industry momentarily forgot that the only business of liability insurers is the assessment and spreading of the costs of insured tort liability. The industry forgot that its only stake in the civil justice system is the *predictability* of the system's rules; it instead sought to dictate the *substance* of those rules, and thereby found itself advocating changes in tort law that would have no bearing on the predictability of its outcomes, but would only affect the cost of those outcomes.

While it could be argued that the costs of these outcomes, no matter how predictable, affect the affordability of liability insurance and are therefore matters of legitimate concern for the industry, it is equally fair to say that the costs of America's system of civil justice are more properly the province of those who *pay* them than of those who merely *spread* them.

Much of the industry's early rhetoric on tort reform stated or implied that the Nation's entire system of civil justice is in crisis. Yet it is a fact that the industry's troubles are confined to a line of coverage -- general liability -- that in 1985 generated only seven percent ($9.1 billion) of the industry's total premiums.

Given the relative ease of identifying the particular decisional or statutory impediment to the insurability of risks in the distressed lines and classes, it was doubly unfortunate that the industry chose not to focus from the beginning on the limited menu of adjustments it needs to protect its capacity to predict and spread risk, but rather elected to join the chorus of cries for more generalized "tort reform."

It was unfortunate first because it diminished the opportunity to achieve these limited adjustments, and second because it converted a relatively minor problem into a war whose ultimate dimensions and consequences have yet to be realized.

Small wonder it was, then, that there was more heat than light in the 1986 debate. Small wonder, too, that those who felt their fundamental rights threatened by insurers' calls for "tort reform" struck back by threatening insurers' fundamental interests in underwriting and pricing freedom.

In the States, therefore, the industry continues to suffer the consequences of the predictable reaction by its regulators to the market dislocations occasioned by the availability and affordability crisis of 1985-86, and by its legislative opponents to the industry's 1986 tort reform offensive. (See appended table on Tort Reform Legislation Enacted in 1986.)

Both regulators and legislators are looking for ways to prevent a recurrence of the availability and affordability problems that plagued the commercial insurance marketplace during 1985 and 1986, through timely identification of factors that could precipitate a similar crisis in the future.

At the same time, both regulators and legislators are under pressure from the plaintiffs' trial bar and other interests to ensure that improved predictability of risk and any loss cost savings resulting from tort reform are reflected in greater insurance availability and lower insurance prices.

To deal with the availability problem in 1986, many States acted, through either regulation or legislation, to impose, on the largely deregulated commercial insurance industry, restrictions on market conduct similar to those already in place in the personal lines -- cancellation, non-renewal, and premium increase notification requirements; and in 13 States, standby authority for the insurance commissioner to establish residual market mechanisms for any line of coverage deemed unavailable in the voluntary market. (See appended table on Joint Underwriting Associations.)

To address the affordability issue, a large number of States in 1986 focused on insurers' reporting of their financial results. Thirty-three States considered new financial reporting requirements for insurers, and 19 States enacted such measures. (See appended table on Financial Reporting Requirements.)

The new reporting statutes vary widely from State to State. At one extreme, Delaware's law requires insurers to supply data on premiums, losses, investment income and acquisition costs in no fewer than 18 classes of business. At the other extreme, Idaho requires insurers to report only product liability premiums and losses. Most of the statutes require insurers to submit the additional data in conjunction with their annual statements, beginning March 1, 1987.

The focus on insurers' financial reporting has sharpened in 1987, at least in part because of the dramatic improvement in industry operating results during 1986. At its annual winter meeting in December 1986, the National Association of Insurance Commissioners (NAIC) appointed a "statistical" working group to review existing financial reporting requirements and recommend improvements that would help insurance regulators identify emerging trends or problems in the commercial liability lines of insurance.

By year-end 1986, all States had adopted a requirement that qualified actuaries prepare and certify a "statement of opinion" that the loss and loss adjustment expense reserves in all lines written by an insurer are correct.

In 1987, many of the States are also moving to "reregulate" commercial liability insurance rates and policy forms. On rating issues, several States have already followed the pattern developed in 1986 in New York, California, and Washington by adopting some form of "flex-rating." This approach requires insurers to justify statistically any upward or downward movement in commercial insurance rates that exceeds specific "flex-bands," usually expressed as percentages of previously filed rates. (See appended Overview of 1986 Rating Legislation/ Regulation.)

Some States may also require insurers to refile their commercial general liability insurance rates to reflect the impact of tort reform enactments. Such refiling requirements may also become a standard quid pro quo for any additional tort reform.

On policy form regulation issues, the States are likely to continue a 1986 trend toward the imposition of minimum policy form standards, particularly for claims-made policy forms. Some States may seek to apply these standards to policies used by surplus lines carriers as well as by admitted insurers.

More regulation of surplus lines insurers, long permitted to do business without the degree of regulatory oversight imposed on admitted companies, can be anticipated, based on developments during 1986.

For example, Colorado, Florida, Ohio, Oklahoma, Pennsylvania, South Carolina and Vermont, among the more than 30 States enacting commercial insurance cancellation and nonrenewal guidelines last year, chose to impose these guidelines on surplus lines insurers as well as admitted carriers.

At the Federal level, Congress reacted, predictably, with proposals to treat the symptoms of the crisis rather than its underlying causes, aided conspicuously by self-appointed insurance consumer advocates whose manifesto included repeal of the industry's limited antitrust exemption, Federal reinsurance, direct Federal insurance, a Federal Insurance Commission, Federal insurance data reporting requirements, and expansion of the Product Liability Risk Retention Act of 1981 to allow group self-insurance of all commercial liability coverages except workers' compensation.

Only one member of Congress, Senator Mitch McConnell of Kentucky, responded to the insurance availability and affordability crisis by introducing a measure to address the underlying problem -- the tort law.

Most of the industry made an early judgment that, of all the possible Congressional reactions to the liability crisis, expansion of the Risk Retention Act would be at once the least damaging to the insurance marketplace and the most objectively useful in mitigating the capacity crunch. The Risk Retention Amendments became law last fall.

SOME POLICY CONSIDERATIONS

There appears to be a widespread belief in Congress, encouraged by those who wish to subject the insurance industry to Federal regulation, that the infamous "cycle" of the property-casualty insurance market can be "tamed" through the enactment of a package of insurance "reforms."

Never mind that evening out the sine curves of prosperity and poverty has eluded the best minds in the business for more than 60 years. Never mind that the price and availability of liability insurance and the profitability of the industry are largely determined by forces external to the business and beyond its control. The industry's critics believe they have all the answers, and a Congress frustrated by constituent complaints about insurance appears eager to buy them.

I can assure you that none of the legislative panaceas before Congress today will make one iota of difference in either the timing or the severity of the next turn of the insurance cycle. The factors underlying this cycle are not and cannot be addressed by legislation confined solely to the business of insurance. These factors include international interest rate differentials; stock and bond market prices and yields; relative rates of return among different sectors of the economy; and the destabilizing influence of revolutions in certain areas of common and statutory law.

Short of nationalizing the entire insurance business, modulating and stabilizing international monetary flows, regulating prices and yields in the stock and bond markets, requiring similar rates of return among all industries, and codifying the common law of torts and insurance contract interpretation, there is nothing the Congress either can or should do that will either make liability insurance cheaper or more plentiful or prevent future insurance cycles.

The current favorite among the legislative panaceas is repeal or modification of the limited antitrust exemption conferred by the Congress on joint industry activities "regulated by State law" under the McCarran-Ferguson Act of 1945. Some of the industry's critics disingenuously argue that McCarran-Ferguson permits the industry to fix prices, notwithstanding the Act's clear statement that the antitrust laws _do_ apply to any potentially anti-competitive conduct that is _not_ regulated by the States. _All_ of the States provide for the regulation of insurance _rates_, and it is hard to imagine a more vivid demonstration of the industry's competitiveness on _price_ than the 1980-84 price war.

Like similar exemptions for other regulated industries, the McCarran-Ferguson Act basically says that any potentially anti-competitive conduct that is not regulated by the States will be subject to the antitrust laws. The Act more or less codified the "state action" exception to antitrust liability, recognizing the impossibility of subjecting collective conduct compelled or authorized under State law to antitrust prosecution.

The proponents of the Act's repeal apparently want the best of both worlds -- continued pervasive State regulation (or dual Federal-State regulation) and open-ended antitrust exposure for any collective conduct that either the FTC, the Justice Department or the plaintiffs' antitrust bar finds offensive to competition. If the goal of the Act's repeal is, as the National Federation of Independent Business (NFIB) contended on April 21, to end "intrusion in the free economy by the Federal Government" and "to set the parameters for competition," then repeal should be accompanied by an affirmative preclusion of either State or Federal regulation.

If the goal is not what the proponents say it is, then what is it? What does the industry do collectively that the Congress finds offensive to pro-competition policy? It seems to us that the burden is upon those who would change the status quo to come forward with examples to prove, to use NFIB's words again, that "the antitrust exemption hinders competition."

We believe that the Act has positively encouraged competition by giving all companies access to jointly collected data on markets that they wish to compete in. We believe that the Act has encouraged cooperative efforts to improve safety, prevent losses, and marshal capacity for jumbo or difficult risks. Its repeal would threaten the smaller competitors in our business as well as the socially useful joint activities the industry engages in, thereby decreasing competition and increasing insurance loss costs.

Another favorite panacea is forced Federal insurance data collection. The State statute books are already littered with similar requirements dating from as far back as the mid-1970's; they have been of zero value even to those who originally advocated them, and they have served only to increase the cost of insurance to those who buy it and to burden regulators with yet more paper.

Data collection might make some sense if the Congress were willing to make significant changes in the common law of torts and insurance contract interpretation. Insurance data, over time, might provide some indication of the effectiveness of these initiatives. But the Congress shows no indication that it is willing to confront the vagaries in our legal system that are gradually rendering insurers' past loss and expense experience both useless for rate making purposes and pointless for public policy purposes. Our data can tell you where we have been in the past, but so long as judges remain free to change the common law of torts or "reinterpret" our contracts on a daily, case-by-case basis, that data will give you no clue as to where we are going in the future.

Those who say they want our data don't want the data to speak for itself; they want the right to interpret -- or worse, deliberately misinterpret -- that data for their own purposes. The House Judiciary Committee staff's misleading treatment of our product liability data last year, and the GAO's ludicrous interpretation of our 1986 operating results are proof enough of that proposition. The fact of the data matter is that the industry is awash in data, and has always been willing to give it to anyone who asked for it, without compulsion.

Our fear is less of being required to submit data we currently collect than of having that data misconstrued or of being asked, as we have been by some States in the past, to spend millions of our policyholders' dollars to collect answers to questions that have no bearing on our risk-spreading function.

Finally, there are those who, out of either ignorance or guile, will tell you, for example, that "(m)any insurers do not base rates on previous loss experience for smaller businesses, which may penalize small firms with a healthy claim history,"[5/] or that the solution to the problem of the high cost of medical malpractice insurance for high-risk specialists is to make low-risk practitioners subsidize them,[6/] thereby suggesting that the Congress ought to put the Federal Government into the business of reclassifying commercial and professional liability insurance risks.

Insurance of all but the very largest risks requires the grouping, or classification, of businesses, governmental entities and professionals with similar exposure to the insured perils, so that each of the many risks in a given classification pays only a small portion of the losses that a predictable minority will incur. It is simply not possible to predict, in advance, which of the hundreds or thousands of risks in a classification will or will not incur a loss in a particular year. Thus, if the loss experience of the class as a whole deteriorates, all its members, not just those with losses, share the burden of increased premiums.

All of the States require the insurance regulator's prior approval of any classification or rating plan that a licensed insurer wants to use, and all of the States require that the rates resulting from a particular rating plan be neither excessive, inadequate, nor unfairly discriminatory. Insurers, subject to State approval, compete with each other by charging less under their own classification plans for risks that they believe are overpriced under their competitors' plans, thereby assuring that insurance classifications and rates strike an appropriate balance between distributive equity and individual loss exposure. Here, as in other areas of insurance regulation, it is competition in the marketplace that is the best arbiter of fairness and reasonableness.

CONCLUSION

The depth and length of the most recent down cycle in the property-casualty insurance business forced the industry to reevaluate its approach to the measurement and pricing of liability risks. Underwriting and actuarial discipline are the current watchwords in most companies as the market gradually recovers.

Some companies decided, in the aftermath of the price war, that they no longer wished to compete in certain lines and classifications of business. Those that remain in these lines are being far more rigorous in their evaluation of individual risk exposure, and are charging prices that reflect careful analysis of the risk's loss potential.

It is no coincidence that the lines and classes in which availability and affordability problems persist are those with the worst loss and expense experience and/or those in which the relevant legal standards are unclear.

The rash of insolvencies precipitated by the 1980-84 price war has heightened insurers' sensitivity to the need for reserve and surplus strengthening, and the improved results anticipated in the coming two years should enable insurers to enter the next tilting of the supply-demand seesaw with healthy balance sheets and a commitment to keeping them healthy through retention of pricing and underwriting discipline.

All past insurance cycles have corrected themselves without Congressional interference. There is every indication that the most recent crisis is well on its way to resolution. It is our firm belief that the best thing Congress can do about the crisis is to sit back and watch the competitive insurance market work its magic again.

We appreciate this opportunity to present our views. I would be pleased to answer any questions you might have.

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FOOTNOTES

1/ Greenman v. Yuba Power Products, Inc., 59 Cal.2d 57, 27 Cal. Rptr. 697, 377 P. 897 (Cal. 1963).

2/ Borel v. Fibreboard Paper Products Corp., 493 F.2d 1076 (5th Cir. 1973).

3/ See Beshada v. Johns-Manville Products Corp., 447 A.2d 539 (N.J. 1982); Elmore v. Owens-Illinois, Inc., 637 S.W.2d 434 (Mo. 1984); Hayes v. Ariens Co., 391 Mass. 407, 462 N.E.2d 273 (1984); Dart v. Wiebe Mfg., Inc., 709 P.2d 976 (Ariz. 1985);

4/ See Halphen v. Johns-Manville Sales Corp., ___ So.2d ___ (No 85-CQ-0455, La. 1986).

5/ Statement of Frank S. Swain, Chief Counsel for Advocacy, U.S. Small Business Administration, before the Committee on Small Business, U.S. House of Representatives, April 21, 1987, at 2.

6/ National Insurance Consumer Organization, "How to Tame the Insurance Industry Cycle and Make the Legal System More Efficient: A Suggested Legislative Agenda for 1987," August 8, 1986, at 27-29.

TORT REFORM LEGISLATION ENACTED IN 1986

STATE	Collateral Source Rule	Joint & Several Liability	Caps on Recovery	Contingent Fee Regulation	Punitive Damage Restrictions	State-of the-Art Defense	Frivolous Suit Penalties	Periodic Payments	STATE
ALABAMA									ALABAMA
ALASKA	X	X	X		X			X	ALASKA
ARIZONA							X		ARIZONA
ARKANSAS									ARKANSAS
CALIFORNIA		X							CALIFORNIA
COLORADO		X	X		X				COLORADO
CONNECTICUT	X	X		X			X	X	CONNECTICUT
DELAWARE									DELAWARE
DIST. of COLUMBIA									DIST. of COLUMBIA
FLORIDA	X	X	X	X	X		X	X	FLORIDA
GEORGIA							X		GEORGIA
HAWAII									HAWAII
IDAHO									IDAHO
ILLINOIS									ILLINOIS
INDIANA	X						X		INDIANA
IOWA					X	X			IOWA
KANSAS									KANSAS
KENTUCKY									KENTUCKY
LOUISIANA									LOUISIANA
MAINE				X				X	MAINE
MARYLAND			X					X	MARYLAND
MASSACHUSETTS	X		X	X					MASSACHUSETTS
MICHIGAN	X	X	X				X	X	MICHIGAN
MINNESOTA	X		X		X				MINNESOTA
MISSISSIPPI									MISSISSIPPI
MISSOURI		X	X						MISSOURI
MONTANA									MONTANA
NEBRASKA									NEBRASKA
NEVADA									NEVADA
NEW HAMPSHIRE			X	X	X		X		NEW HAMPSHIRE
NEW JERSEY									NEW JERSEY
NEW MEXICO			X						NEW MEXICO
NEW YORK	X	X					X	X	NEW YORK
NORTH CAROLINA									NORTH CAROLINA
NORTH DAKOTA									NORTH DAKOTA
OHIO									OHIO
OKLAHOMA					X		X		OKLAHOMA
OREGON									OREGON
PENNSYLVANIA					X				PENNSYLVANIA
RHODE ISLAND	X						X	X	RHODE ISLAND
SOUTH CAROLINA									SOUTH CAROLINA
SOUTH DAKOTA			X					X	SOUTH DAKOTA
TENNESSEE									TENNESSEE
TEXAS									TEXAS
UTAH		X	X					X	UTAH
VERMONT									VERMONT
VIRGINIA			X						VIRGINIA
WASHINGTON		X	X	X				X	WASHINGTON
WEST VIRGINIA		X	X		X		X		WEST VIRGINIA
WISCONSIN									WISCONSIN
WYOMING		X	X				X		WYOMING

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OVERVIEW
JOINT UNDERWRITING ASSOCIATIONS
1986 ENACTED LEGISLATION

STATE	ALL PERSONAL AND COMMERCIAL LINES	ALL COMMERCIAL LINES	EXCLUDES ENVIRONMENTAL LIABILITY	ASSESSMENT BASE	INSURERS ASSESSED FOR LOSSES	PROVISION FOR RECOUPMENT OF ASSESSMENTS	OPERATIONAL	STATUTE SUNSETS
Arizona		X****		Premiums on all casualty lines.	Yes	Yes	No	No
Florida	X			Premium on those lines written in JUA.	Yes	No	No	No
Iowa	X		X	Uncertain	Yes	No	No	No
Kentucky		X	X	Premium on those lines written in JUA.	Yes	Premium Tax Offset	No	7/1/88
Maryland		X*		Premium on all commercial casualty	Yes	Policyholder Surcharge	No	No
Minnesota	X		X	Premium on all commercial lines excluding workers compensation and med. mal.	Yes	Premium Tax Off-Set	Yes	No

Mississippi		X****		Uncertain	No	N/A	No	No
Montana		X		Uncertain	No	N/A	No	7/1/89
New York		X		Premium on all commercial lines excluding med. mal. and automobile.	Yes	No	No	6/30/88
North Carolina	X			Uncertain	Yes	No	No	6/30/88
Vermont		X	X	Uncertain	No	N/A	No	No
Washington		X**		Uncertain	No	N/A	Yes	No
West Virginia	X			Uncertain	Yes	Premium Tax Offset	Yes	No

* Day Care Centers, Municipal Liability, Engineers, Architects and Coal Operators.
** Day Care Centers
*** Manufacturers, Contractors and Owners, Landowners and Tenants Insurance
**** Licensed Midwives

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Vice President

October 17, 1986

TO : Messrs. W. Buckley
B. Bunaes
L. Carr
R. Puccinelli
R. Vairo

FROM: Robert J. Sullivan and Norman E. Nelson

RE : **1986 RATING LEGISLATION/REGULATION**

Attached for your information is an overview of legislation enacted in 1986 impacting on state rating laws for both personal and commercial lines. An overview is also provided for those states where the Commissioner of Insurance has adopted new regulations for the filing of commercial liability rate increases.

Although there were rating bills introduced in over half of the fifty states, only twelve states passed some form of rating legislation. Of the four states still in legislative session, only New Jersey, which is giving serious consideration to putting a "flex-rating" program into place, is considered likely to enact rating legislation.

Of the twelve states enacting amendments to their rating laws, only Florida, Hawaii and New York chose to artificially depress commercial liability rate levels. Florida froze commercial liability rates for six months and mandated premium rebates between 6 and 10 percent over a three-month period. Hawaii froze commercial liability rates for a two-month period and mandated consecutive rate reductions of 10 percent in 1986, 12 percent in 1987 and 15 percent in 1988. New York mandated commercial rate reductions averaging 7 percent to reflect the impact of tort reform legislation enacted in 1986.

The most comprehensive and restrictive rating legislation enacted came from Florida and New York.

Florida amended its competitive rating law (use and file) to newly require that commercial insurers either file their rates for Insurance Department approval sixty days prior to their effective date or file their rates no later than thirty days after their effective date. However, under the thirty-day option, the insurer may be ordered to make refunds to its policyholders should the Insurance Department find the rates to be excessive. Florida insurers are also required to file new manual rates to be effective January 1, 1987 for all commercial liability. In filing their new rates, insurers must include in the filing the impact of recently-enacted tort reform legislation.

New York's new rating law, scheduled to expire on June 30, 1988, provides that "flex-rating" will apply to those lines of business so designated by the Superintendent of Insurance. Flex-rating is a unique hybrid of "open competition" and "prior approval" rating systems. Under the flex-rating system, insurers writing selected commercial lines are allowed to deviate rates within an established percentage range without receiving prior approval of the Superintendent. If an insurer intends to use a rate that falls outside the flex-rating range, prior approval must be obtained from the Superintendent.

Other states adopting programs limiting insurer rate flexibility include California, Oregon and West Virginia.

California's Insurance Commissioner issued a directive on October 14, 1986 requiring insurers to file supporting rate information on commercial liability and commercial automobile rate increases of 25 percent or more.

In Oregon, insurers must submit commercial liability rate increases of 25 percent or more to the Commissioner for approval. Oregon currently has a "use-and-file" rating law. West Virginia, through legislation, limits annual premium increases for municipal liability insurance to 10 percent.

Fortunately, the rating legislation enacted in the following states will have no significant impact on an insurer's ability to apply adequate rates to its book of business.

- In Colorado commercial insurers will have to file rating information for the first time; however, rate filings do not require the Commissioner's approval.

- Connecticut passed two rating bills. One bill establishes a committee to study the process by which insurers establish rates for liability insurance; the other requires that commercial rate filing must specify an effective date which can be different for new business and renewals. Louisiana's House Bill 1329 provides that the state attorney general shall represent the interest of the people in all proceedings before the Insurance Rating Commission.

- Michigan's rating law has been amended, requiring that all admitted insurers file a merit-rating plan which would provide premium discounts for risk management programs.

- Vermont's legislators took a somewhat unique approach--the Commissioner of Insurance is required to hold a hearing to determine whether a competitive market exists "whenever in any market, over a twelve-month period, the average for all premiums in any line of insurance increases by 25 percent or more".

- Washington's Senate Bill 4630 directs the Commissioner, when reviewing a commercial rate filing, to determine whether the insurer should grant the policyholder a credit.

- Maryland's Commissioner declared that a competitive insurance market did not exist for day care centers, police departments, directors and officers liability, lawyers liability and public bus systems and ordered that rate changes for these lines be submitted for "prior approval".

- In mid-August Commissioner Dale of Mississippi announced a five-month freeze on all rates until January 1, 1987.

- In Washington State, Commissioner Washburn implemented a form of flex-rating. As of January 1, 1986, Washington insurers were prohibited from applying debits or credits in excess of 25 percent to most commercial lines of business.

States enacting amendments to their rating laws primarily affecting personal lines include California and Iowa. In California insurers will no longer be permitted to increase an insured's premium based upon an accident when the insured is not at fault and, effective July 1, 1987, must reduce automobile liability premium for insureds over 55 years of age who have successfully passed an approved driver education course.

Iowa's rating legislation requires automobile insurers to reduce liability premiums to reflect the savings resulting from the mandatory seat belt law.

If you have any questions on the attached report, please give me a call on Ext. 7143 or Norm Nelson on 3951.

RJS NEN

R. J. S. and N. E. N.

Attachment

CC: Messrs.
D. Carmichael
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S. Wentz
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G. Yeager

OVERVIEW OF 1986 RATING LEGISLATION/REGULATION

CALIFORNIA

Senate Bill 1763 - January 1, 1987

Senate Bill 1763 prohibits a motor vehicle liabilty insurer's rating plan from providing for a premium increase based upon an accident when the insured is not at fault in any manner.

Assembly Bill 2610 - Effective July 1, 1987

Assembly Bill 2610 requires motor vehicle liability insurers to reduce the premium rates for drivers 55 years of age or older by an amount determined by the insurer, based on actuarial and loss experience data, if the driver completes a state-approved improvement driving course. The insured would be required to successfully complete the driving course every three years to continue to be eligible for any premium reduction. An insurer may discontinue the premium discount if the insured is involved in an "at fault" accident, is convicted of a moving traffic violation, or is convicted of a traffic-related offense involving alcohol or narcotics.

Insurance Department Bulletin - Effective November 15, 1986

California's current rating law provides that rates shall not be excessive, inadequate, or unfairly discriminatory. Under this competitive rating law, insurers are not required to file any of their personal or commercial lines rates.

On October 14, 1986 Insurance Commissioner Roxani M. Gillespie issued a directive to all California licensed insurers requiring actuarial justification of rate increases for commercial liability and commercial automobile.

Effective November 15, 1986 any insurer or rating organization implementing an annual aggregate rate increase of 25 percent or more for any commercial liability or commercial automobile classification must submit documentation to the Department of Insurance justifying the increase. The Department has 60 days to determine whether the increase is justifiable or not. Should the rate increase not be supported by the Department, further use of the rate will be prohibited. This filing requirement does not apply to excess insurance or surplus lines.

COLORADO

House Bill 1204 - Effective July 1, 1986

Under current law Colorado does not require the filing of rates except for workers compensation and employer's liability, medical malpractice, auto assigned risk, and insurance written by captive insurance companies. (These lines require prior approval). House Bill 1204, effective July 1, 1986, newly requires that insurers must file rating information on all subsequent rate changes for all lines of business concurrent with the rate change effective date. These rate filings do not require the Commissioner's approval.

House Bill 1358 - Effective July 1, 1986

House Bill 1358 amends Colorado's Insurance Code to permit the Commissioner to promulgate reasonable rules requiring any insurer to file supplemental reports or closed claim data or both, which would allow the Commissioner to determine the appropriateness of rates, to determine whether to convene a hearing or to investigate significant availability or affordability problems. This law will sunset on July 1, 1989.

CONNECTICUT

House Bill 5400 - Effective October 1, 1986

House Bill 5400 establishes a joint standing committee on insurance and real estate to study the process by which insurers establish rates and premiums for liability insurance coverage. The study will include, but not be limited to, an analysis of market influences, underwriting standards, reserving practices, investment income and its relationship to the ratemaking process, an evaluation of the claims-made general liability policy form and systems for the classification of insureds, and an evaluation of the powers and duties of the Insurance Commissioner relative to the establishment of such rates and premiums, with specific recommendations regarding the advisability of a system of mandatory approval by the Commissioner of any proposed change in rates and premiums or contract terms and conditions upon renewal by an insured of any liability insurance policy.

As part of such study, the committee will evaluate the feasibility of establishing an office of consumer advocate within the Insurance Department, and the likely effects that such an office would have on insurance in this state. On or before December 1, 1986, the committee will issue a final report of findings and recommendations to the Governor and the General Assembly.

House Bill 5324 - Effective January 1, 1987

House Bill 5324 provides that whenever a filing is submitted to revise the rates or supplementary rate information applicable to any personal and commercial property/casualty insurance, it shall specify an effective date. The filing may specify separate effective dates for new business and renewal business.

Such rates or supplementary rate information shall only apply to policies with an inception, continuation, or renewal effective date on or after the appropriate filing effective date, regardless of the date the policy is written, issued, processed or delivered.

If either a coverage is changed or an exposure is added during the policy period, the insurer shall specify, at the time of the original filing, whether the applicable rates will be (1) the rates in effect at the beginning of the policy period, or (2) the rates in effect on the effective date of the change in coverage or the addition in exposure. If the latter rates are specified, such rates shall apply only to the changed coverage or the added exposure.

FLORIDA

Senate Bill 465 - Effective July 1, 1986

Senate Bill 465 amends Florida's competitive rating law to now require that all commercial (except workers compensation, employer's liability and commercial auto) and personal (except private passenger auto) rates and rating plans be filed with the Florida Department of Insurance under one of the following procedures:

- Rate filings must be made at least 60 days prior to their effective date. The rate shall be "deemed" approved if the Department does not disapprove the rate prior to the expiration of the 60-day period; or

- Rate filings to be made as soon as practicable but no later than 30 days after their effective date. Under this procedure, an insurer could be required to return to its policyholders any portion of its rates found to be excessive by the Commissioner. This latter requirement may discourage insurers from using this alternate procedure on many rate filings.

For individual risks that are not rated in accordance with the insurer's filed rates and which have been submitted to the insurers for individual rating, the insurer is required to file rates with the Department as soon as practicable following the effective date of the policy, but in no event more than 90 days thereafter.

On or before October 1, 1986, every admitted insurer and licensed rating organization must file for approval with the Florida Department of Insurance new manual rates for commercial liability insurance based upon those rates that were in effect on January 1, 1984 adjusted only to reflect changes in coverage and investment income. While the initial adjustment for these rates does not permit adjustment for loss experience occurring since January 1, 1984, the bill does provide a procedure for insurers to request an exception to this prohibition with the burden on the insurer to actuarially justify any further adjustments based upon the insurer's loss experience since January 1, 1984.

All rate filings will be deemed approved on March 1, 1987 unless by such date the Department has issued a notice of intent to disapprove the filing.

In filing new commercial liability rates to become effective on January 1, 1987, insurers must include in the filing the expected impact on losses, expenses and rates of the tort reform contained in the bill.

HAWAII

Senate Bill 1 - Effective August 4, 1986

Provisions of Senate Bill 1 call for a moratorium on rate increases for commercial liability insurance during the period of August 1, 1986 to September 30, 1986. A 10 percent rate reduction must be implemented for all rates on file for commercial liability insurance (except motor vehicle and medical malpractice) for new and renewal policies for the period of October 1, 1986 to September 30, 1987. A 12 percent rate reduction for commercial liability insurance (except motor vehicle) is imposed for the period of October 1, 1987 to September 30, 1988. A 15 percent rate reduction for commercial liability insurance (except motor vehicles) is imposed for the period October 1, 1988 to September 30, 1989.

An insurer is permitted to file for a rate increase if it can actuarially prove that the reduced rate is financially unsound. The Commissioner must approve or disapprove such a rate filing.

The Insurance Commissioner is also empowered to determine whether any rate is excessive and to order a refund of premiums to policyholders where a finding of excessiveness is made.

IOWA

Senate Bill 2210 - Effective July 1, 1986

Requires insurance companies to lower automobile liability premiums to reflect the reduction in annual losses occasioned by the enactment of the mandatory seat belt law.

In making the determination on the amount of reduction of automobile liability insurance premium, which takes effect on all policies issued after July 1, 1987, the Commissioner may employ the services of an actuary which cost shall be assessed against licensed insurers.

LOUISIANA

House Bill 1329 - Effective July 1, 1986

House Bill 1329 provides that in all proceedings before the Insurance Rating Commission, the attorney general shall have the right to represent the interest of the people of the State of Louisiana.

The attorney general, or his designee, shall have the right to question witnesses, including industry or company representatives and all others appearing before the Commission, and shall have the right to issue subpoenas to compel the attendance of witnesses and the production of documents.

MARYLAND

Maryland is a "file and use" state for all lines of business except medical malpractice.

Maryland's rating law authorizes the Insurance Commissioner, after a hearing, to declare that a competitive market does not exist for a given line of business and therefore future rate changes for such line of business must be submitted to the Commissioner for approval.

So far in 1986 the Commissioner has declared that there is not a competitive market for the following lines of business and has ordered that rate changes for these lines must be submitted to the Department for "prior approval":

- Day Care Facilities
- Public Entity Protection
- Directors and Officers Liability
- Buses other than School and Church Buses

- Lawyers Professional Liability

The Commissioner's order will expire on May 6, 1987.

MICHIGAN

House Bill 5209 - Effective July 6, 1986

House Bill 5209 amends the Michigan rating law.

A new definition of inadequate rates for commercial liability insurance is provided. Rates could be considered insufficient to sustain projected losses and expenses only after consideration of investment income, marketing programs, and underwriting programs. All admitted companies which sell commercial liability insurance will be required to file a merit-rating plan which would provide premium discounts for risk management programs. Surcharges for medical malpractice will be allowed subject to the following limitations:

- the surcharge plan must be filed with the Commissioner;
- surcharges may not be based on an action that was filed more than three years immediately preceding the issuance or renewal of the policies;
- surcharges may not be based on an action for which the insured has been adjudged not liabile or which has been dismissed or settled without indemnity being paid on behalf of the insured;
- surcharges may not be based on an action for which the insurer pays, on behalf of the insured, indemnity and loss adjustment expenses with respect to such action in an amount which is less that 51 percent of the annual premium paid by the insured for the policy covering such action.

Liquor liability insurers must develop and maintain a server-training discount plan which would provide a discount for such policies based on the completion of a certified server-training course.

MISSISSIPPI

Mississippi is a "prior approval" state for all personal and commercial rate filings.

In mid-August, Commissioner of Insurance, George Dale, made a public announcement that there would be no rate filing approved until after January 1, 1987.

NEW YORK

Senate Bill 9351-A - Effective June 28, 1986

The rating law provision of the Senate Bill 9351-A applies to all commercial lines excluding workers compensation, medical malpractice, mortgage guaranty, credit property and risks insured in residual market mechanisms such as the FAIR Plan and Automobile Assigned Risk. Also exempt are policies in risk-sharing plans and joint underwriting ventures.

The rating provisions of Senate Bill 9351-A expire on June 30, 1988, except that subsequent rates must reflect the reductive cost of tort reform.

The new law provides that "flex-rating" must apply to those lines of business so designated by the Superintendent. The Superintendent may exempt from flex-rating those commercial lines of business where it is determined that competition is sufficient, rates are not excessive or inadequate or detrimental to the solvency of insurers. Flex-rating is a unique hybrid of "open competitive" and "prior approval" rating systems. Under the flex-rating system, insurers writing selected commercial lines are allowed to deviate rates within an established percentage range without receiving the prior approval of the Superintendent. Rate changes beyond the flex-rating limits will be subject to prior approval.

The Superintendent is also required to promulgate a regulation establishing standards for commercial rating plans (including experience rating, scheduled rating, individual risk modification plans and expense reduction plans). The regulation is to establish maximum debits and credits that may apply to a rate because of a rating plan. Upon promulgation of the regulation, insurers' rating plans must be filed or refiled for approval in accordance with the regulation.

All future commercial rate filings which are subject to "prior approval" will not become effective unless the rate filing has been approved, or 30 days (previously 15 days) has passed. The Superintendent may, with cause, extend the approval period 30 and 15 days respectively.

OREGON

Regulation - Effective November 4, 1986

Oregon is a "file and use" state for commercial lines. The new regulation provides that commercial casualty rate changes, to be effective as of November 4, 1986, must be submitted to the Commissioner of Insurance for review if such rate changes would result in the insured's premium being increased more than 25 percent. The increase would be deemed approved unless disapproved within 30 days (or any extended period) by the Commissioner.

VERMONT

House Bill 657 - Effective June 4, 1986

House Bill 657 amends Vermont's competitive rating law by requiring the Commissioner of Insurance to hold a hearing to determine whether a competitive market exists "whenever in any market over any twleve-month period, the average rates for all premiums in any line of insurance increase by 25 percent or more". In the absence of such hearings, a competitive market is presumed to exist.

WASHINGTON

Senate Bill 4630 - Effective June 11, 1986

Washington is a "file and use" state for commercial lines.

Rates become effective in thirty days unless disapproved by the Commissioner.

Senate Bill 4630 adds a new section to the rating law which requires the Insurance Commissioner, in reviewing a casualty rate filing, to determine whether the insurer should grant the policyholder a credit in such casualty rate filing. The Commissioner may disapprove any casualty rate filing that is inadequate, excessive or unfairly discriminatory.

Regulation - January 1, 1986

The State of Washington was the first state to adopt a form of flex-rating through limitation on the use of schedule rating debits and credits.

Under the regulation effective January 1, 1986, insurers are prohibited from applying debits or credits in excess of 25 percent to those commercial classes of business commonly known as crime, fire, general liability, inland marine, multiperil and commercial automobile. The standards do not apply to those commercial auto risks generating less than $2,500 annual premium or any of the other commercial lines generating less than $1,000 in annual premium.

WEST VIRGINIA

Senate Bill 3 - Effective June 1, 1986

Senate Bill 3 provides that any rate filing relating to liability insurance for political subdivisions must be accompanied by such information as the Insurance Commissioner requires in order to determine claims payouts, premium income, investment income, loss reserves, administrative expenses, profits, losses and such other information deemed necessary by the Commissioner to determine the profitability of such business. Liability insurance coverage for political subdivisions may not be reduced without the written consent of the insured and policy premium may not be increased by more than 10 percent per annum.

The statute gives the Commissioner the authority to disapprove any casualty rate filing, which includes liability coverage for political subdivisions, for failure to provide the required information.

FINANCIAL REPORTING REQUIREMENTS

GENERAL INFORMATION

STATE	DUE DATE	STATE	COUNTRY WIDE	REPORT YEARS
Arizona	March 1, 1987	X		1986
California	May 1, 1987	X	X	1986
Delaware	March 1, 1987	X	X	1977-1986
Florida (claims only)	Dec. 1, 1986	X		1981-1985
Georgia	March 1, 1987	X		1986
Idaho	March 1, 1987	X	X	1986
Illinois	Call of Comm.	X	X	1986
Indiana	March 1, 1987	X		1986
Louisiana	March 1, 1987	X	X	1986
Maryland (claims only)	Call of Comm.	X		[illegible]
Minnesota	May 1, 1987	X	X	Last 6 mos 1986
New Mexico *	Call of Comm.	X	X	?
New York (claims only) **	Call of Comm.	X	X	1981-1986
North Carolina	March 31, 1988	X		1987
Ohio	March 1, 1988	X		1987
Oklahoma ***	Jan. 31, 1987	X		1986
Washington	March 1, 1987	X		1986
W. Virginia (claims only)	Call of Comm.	X		1986
Wisconsin	May 1, 1987	X		1979-1985

* Quarterly Reports
** Ten Largest Insurers
*** Fifty Largest Insurers

Statement
# of the
Chamber of Commerce
# of the
United States

ON: PRODUCT LIABILITY REFORM

TO: SUBCOMMITTEE ON ANTITRUST, IMPACT OF DEREGULATION, AND PRIVATIZATION OF THE HOUSE COMMITTEE ON SMALL BUSINESS

BY: MARCUS M. GRIFFITH

DATE: MAY 13, 1987

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents approximately 180,000 businesses and organizations, such as local/state chambers of commerce and trade/professional associations.

More than 91 percent of the Chamber's members are small business firms with fewer than 100 employees, 58 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business--manufacturing, retailing, services, construction, wholesaling, and finance--numbers more than 11,000 members. Yet no one group constitutes as much as 29 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 56 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
PRODUCT LIABILITY REFORM
before the
SUBCOMMITTEE ON ANTITRUST, IMPACT OF DEREGULATION, AND PRIVATIZATION
of the
HOUSE COMMITTEE ON SMALL BUSINESS
for the
U.S. CHAMBER OF COMMERCE
by
Marcus M. Griffith
May 13, 1987

I am Marcus M. Griffith, President of the Hairlox Company, Inc., of Washington, D.C. I am appearing on behalf of the U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce, and trade and professional associations. I am President of the District of Columbia Chamber of Commerce and a member of the U.S. Chamber's Council of Small Business, which is composed of small business leaders who recommend small business policy to the U.S. Chamber's Board of Directors. The Chamber appreciates this opportunity to present its views. It is a pleasure for me to be here.

The Chamber strongly supports federal product liability reform--a reform that is critical to the vitality of American business. For over a decade, the business community has sought to bring uniformity, predictability, and fairness to our product liability laws. Our plea is louder today because the need for a uniform federal product liability law is more urgent than ever. While we are pleased that this Subcommittee is holding hearings on product liability, we are disappointed by the failure of Congress to have passed a federal product liability reform law by now. We reemphasize our desire to see Congress pass a product liability reform bill this year.

Today, product liability reform is at the "cutting edge" of a widespread and growing public movement favoring overall tort reform. It is precisely this outcry for tort reform that prompted the more than 1800 delegates to last year's "White House Conference on Small Business" to rank tort reform as their number one policy recommendation and federal product liability reform as number nine.

As a delegate to that Conference, I fully appreciate how this issue profoundly affects small business. The delegates to the Conference were not large corporations, but representatives of small businesses of every type. Those who still contend that this is a "big business" issue ignore reality. It is the American small business community whose operations are crippled by protracted litigation. It is the small manufacturer who finds it increasingly difficult to compete with foreign companies, which are not subject to the threat of product liability suits. And it is the small distributor who is more reluctant to market new products for fear of irrational lawsuits, which they cannot afford to litigate.

We all have heard by now more stories than we wish to recount on how this product liability crisis has affected various segments of the American business community. However, Mr. Chairman, if you would allow me, I would like to share wfth the Subcommittee my personal experience.

My company, Hairlox, Inc., a hair product manufacturing firm, has been in business for the past 17 years. This is the first year in the company's history that I have operated the business without product liability insurance coverage. Hairlox, like many other small businesses across this nation, is "going bare."

Mr. Chairman, this decision to drop my product liability insurance was an extremely difficult decision for me to make, as I know it has been for many of my colleagues. It was, however, a necessary decision because the cost of product liability coverage for my company was unaffordable.

Thus, I had to weigh the consequences of operating without product liability insurance from a cost/benefit perspective. The cost of my product liability insurance premiums would have been so expensive that the probability of deriving any benefit from coverage was minimal. Other factors which I had to consider was the fact that my company had never had a catastrophic claim filed against it and that those small claims which had been filed were settled--and I might add, not because of the meritorious nature of the claims, but because of the expense in defending a product liability lawsuit.

Indeed, product liability insurance affordability and availability are the result of problems that businesses face with our current tort system. But, even if product liability insurance somehow was made available to all who wanted it, problems arising from excessive product liability suits would remain. Specifically, corporate bankruptcies resulting from unending litigation would continue; product prices would continue to increase to reflect higher litigation costs; and new products would be withdrawn from or not introduced in the market by businesses under the threat of lawsuits. Only when logic and fairness are incorporated into the civil justice system will these problems begin to correct themselves.

A significant factor in subverting U.S. competitiveness is this nation's absurd product liability laws. Because U.S. manufacturers bear a much higher product liability risk than foreign competitors, they must pay excessive product liability insurance premiums, which, in turn, are reflected in the cost of U.S. products and services.

Not only are U.S. manufacturers forced to charge more for their products, but also the threat of product liability lawsuits is driving many companies out of basic products lines altogether and is discouraging them from launching new ones. Our foreign competitors, who are less victimized by U.S. liability laws and who enjoy more rational systems in their own countries, are at a distinct advantage.

The field of health care is a prime example. Consider the case of Wepco, Inc., of Vienna, Virginia, a small enterprise that once manufactured hand and foot driving controls for the handicapped. Although Wepco's product was endorsed by the Veterans Administration, and the firm had never been sued successfully, its product liability insurance cost rose so dramatically it was forced to shut down in September 1986. Its president, William Perry, is now a consultant to other manufacturers, many of whom are foreign competitors.

Early in 1986, G.D. Searle and Company announced it would stop sales of its Copper 7 interuterine devices in the U.S., even though they were reputed to be safest of all IUDs. Searle spent $1.5 million successfully defending itself against four lawsuits in 1985, a prohibitive cost for a product whose annual sales amounted only to $11 million.

Because of the product liability epidemic, Lederle Laboratories has been forced to hike the cost of its vaccine for diphtheria, tetanus, and pertussis (DTP) from $2.80 in June of 1986 to $11.40 today. Rising insurance costs and the threat of litigation previously had forced Wyeth Laboratories to abandon the sale of the DTP vaccine altogether. Today, with about 150 product liability suits pending against Lederle, the very availability of this valuable medicine is in jeopardy.

Sports equipment manufacturers also have been hard hit. There are only two remaining makers of lacrosse equipment in the U.S., one of which recently learned its annual liability insurance premium was jumping from $8,000 to $200,000. Only two domestic makers of trampolines still exist, and more than a dozen companies have given up making football helmets in the last 10 years. One helmet manufacturer was socked with a $12 million judgment in the case of a high school football player who broke his neck. The jury decided the helmet manufacturer should have warned users of the dangers of butting heads with it. Today, one of the two remaining helmet manufacturers is up for sale. Its $8 million in sales has been consumed by liability premiums of $1.5 million, which only covers losses greater than $2 million and carries a $4 million deductible.

Lawsuits threaten to choke the computer industry and already are inhibiting innovation. There are inherent risks in the production of any new product, and especially those involving high technology. Computer programs used in industries such as health care, transportation, and hazardous waste disposal expose their makers to enormous liability should a jury later determine that a computer program could have made a product safer. Too many U.S. firms are simply turning their backs on promising new ideas and products because of the unpredictable product liability factor.

Lawsuits filed by consumers are part of the problem, and lawsuits filed by employees are another. In Europe and Japan, injured employees almost never sue their employers, relying instead on workers' compensation. However, workers in this country, lured by television commercials and the promise of financial windfalls, rarely are satisfied with workers' compensation.

Producers of specialized machinery used by the paper industry have been hard hit by this trend. These machines are misused routinely by employees who fail to follow manufacturers' instructions; misuse leads to injuries and, of course, lawsuits. Not long ago, this industry was a positive contributor to our balance of trade. Today, it is losing ground to foreign competitors even in our domestic market. Because of our product liability laws, an industry that enjoyed a $109 million trade surplus in 1982 generated a deficit of $215 million in 1986.

The problem is compounded because of the great number of American products in use that were made years ago. In general, modern products are safer than their predecessors, but U.S. firms must still face product liability for items sold decades before. For example, Piper Aircraft Corporation's insurance bills, which reflect the risk of lawsuits over any Piper aircraft still flying, amount to $75,000 for every new plane built, more than the total cost of manufacturing the firm's smaller aircraft. This has forced Piper and other old-line aircraft makers, Beech Aircraft and Cessna Aircraft, to abandon many lines and shut plants.

Because they have relatively few older foreign products in the U.S., foreign firms have a shorter "liability tail," even when they are subject to our laws and exposed to lawsuits, which is not often. It is difficult to sue and enforce judgments against foreign manufacturers doing business in this country. Assets of foreign corporations seldom can be attached if the firms maintain no offices or plants in the U.S.

To make matters worse, on February 24, 1987, the U.S. Supreme Court refused to allow an indemnity action against a Japanese supplier of tire valves which had given rise to a liability suit [Asahi Metal Industry v. Solano County Superior Court]. The case reemphasized that, unless a foreign manufacturer has a highly visible presence, it is unlikely to be sued in this country. Foreign manufacturers only will face product liability actions where the case for product liability is strong and potential damages are substantial. Unlike suing a U.S. manufacturer, it is highly unlikely a frivolous suit or a case with questionable damages would be initiated.

The upshot is that many foreign producers, virtually immune to this country's legal system, carry little or no product liability insurance--giving them a tremendous advantage.

However, when foreign citizens file claims in U.S. courts against American firms doing business overseas, they can win easily. The extraterritorial jurisdiction of U.S. courts is so broad that U.S. firms operating in other nations are subject to this country's liability laws.

Foreign competitors long have been amused by our propensity to sue one another in a legal system where the only real winners are plaintiffs' attorneys and to permit them to sue us when we can rarely sue them. They surely think we are not very bright and with good reason.

The key difference between the U.S. and its foreign competitors in the product liability area comes down to our "pot of gold" mentality, in which every citizen regards an injury or loss as an invitation to win the lottery. The root causes of this aberrant mentality are:

1) The doctrine of joint and several liability which disregards fault as a basis for recovery. It would be difficult to conceive of any concept more at odds with traditional notions of justice and fair play. This doctrine facilitates a shotgun approach--naming as many defendants as possible, especially one with "deep pockets" who usually is stuck with the bill.

2) Routine pain and suffering awards and punitive damage awards, which are rare in other nations and often prohibited altogether.

3) Evolving legal standards, such as strict liability, which disregard fault as a criterion upon which to predicate liability.

4) Allowing plaintiffs double recoveries, when an injured party already has received collateral benefits.

The effect is to make litigation a national pastime. For many large corporations, defending against product liability lawsuits is an everyday business expense, like paying the electric bill. However, it is a major expense for small businesses--one they cannot afford, and one with which our foreign competitors do not have to deal.

Because of this litigiousness and the inability to predict product liability exposure with any degree of accuracy, product liability insurance firms are being forced to raise their rates substantially or to get out of product liability insurance business altogether. A 1984 study commissioned by the U.S. Department of Commerce found foreign competitors have product liability insurance costs 20 to 50 times lower than their U.S. competitors. Please note that this study was done before the liability insurance crisis erupted in 1986. Between 1985 and 1986, for example, the average insurance premium for machine tool builders jumped 55 percent to $253,700 a year.

Federal product liability reform and state tort reform lie at the heart of our nation's quest to become more competitive. The Reagan Administration recognized this fact in its "competitiveness package," which recommends priority be given to product liability reform.

The solution is not simply to restrict the product liability of U.S. producers, but to make an unjust system fairer. Reforms must include limits on the use of joint and several liability and reemphasis of fault as a basis for liability. Recovery of noneconomic damages and double compensation also must be restricted.

There is overwhelming public support for product liability reform. A poll released by Lou Harris and Associates on March 6, 1987, showed the public favors, by a margin of 71 to 26 percent, modifying product liability laws to hold manufacturers liable for damages only if it is proven they have been careless or negligent. That sentiment translates into votes, as the citizens of California demonstrated convincingly in last fall's Proposition 51 referendum.

Mr. Chairman, the U.S. Chamber of Commerce is supportive of legislation, such as H.R. 1115, the Uniform Product Safety Act of 1987, introduced by Representative Bill Richardson (D-NM). We believe this legislation would provide meaningful product liability reform.

And the time has come for Congress to enact meaningful product liability reform. If Congress truly is concerned about this country's competitiveness, this would be an excellent and effective way to demonstrate it. Product liability reform will enable American producers to compete with foreign manufacturers on a more level liability playing field.

Thank you for inviting us to testify. I would be happy to take any questions you might have.

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National Federation of
Independent Business

NFIB

STATEMENT OF

JOHN MOTLEY
DIRECTOR OF FEDERAL GOVERNMENTAL REALTIONS

ON BEHALF OF
THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: House Small Business Committee, Subcommittee on Antitrust, Impact of Deregulation and Privatization

Subject: The Liability Crisis & Its Impact on Small Business

Date: May 13, 1987

Introduction

On behalf of the over 500,000 members of the National Federation of Independent Business, I would like to thank you, Congressman Eckart, for holding this hearing on the impact of the liability crisis on small business and express our appreciation to the rest of the Subcommittee members for participating in them.

As you may know, the National Federation of Independent Business has been concerned over the years about the general issue of insurance. NFIB primarily represents main street and rural small businesses -- the average member employs less than ten individuals. NFIB members could be considered a leading indicator of the economy. When the general economy prospers, our members generally prosper. When the economy does not do so well, our members generally feel immediate economic pain through lower sales of goods and services.

Because NFIB represents such a cross section of small business, we believe we can say with certainty that NFIB speaks for America's entrepreneurs. And the concern dominating entrepreneurs' thoughts is insurance.

NFIB members were among the first to feel the so-called "liability insurance crisis" experienced in our country over the past several years. It's appropriate to use the phrase "liability insurance crisis" because many saw no logical or market-based justification for small business liability insurance premiums dramatically increasing in price regardless of their risk rating, or for the significant cut many faced in insurance coverage. NFIB has received many calls and letters from small business owners who were good risks for liability insurance policies but who cannot even get insurance, no matter the price, because policies were no longer offered.

I am here before this Subcommittee today because the liability insurance issue is probably the most critical and serious issue confronting small business. NFIB's Institute for

Enterprise Advancement issued its *Small Business Problems and Priorities* in June of last year, ranking the top 75 problems small businesses face. In that survey, small business ranked the cost of health insurance as its number one problem area, with 33% of those sampled noting it was a critical problem. They ranked the cost and availability of liability insurance as the number two problem. However, 38% of small business viewed this as a *critical* problem, *the highest percentage describing a problem as "critical" in the survey*.

Furthermore, NFIB's field force of over 700 individuals regularly conducts a field survey with small businesses across the nation to get a sample of their views and concerns. The last two field surveys provided them with the following data:

- Asked the question of which issue is the most important affecting business, 44% chose liability insurance;
- Asked if liability insurance premiums had increased by 50% or more, 41.5% said yes.

These field surveys reveal to us, Mr. Chairman, that the liability issue has not gone away.

Furthermore, the number one priority at the national White House Conference on Small Business, made up of 1,813 delegates and held in Washington last August, was the liability insurance issue. I ask the Subcommittee's permission to submit the number one recommendation for the record.

All of these data tell me that the insurance issue is on the minds of small business owners everywhere and that action must be taken to resolve the problem.

While you may have heard examples of small business difficulties with liability insurance, I would like to give the committee some examples of problems generally being faced by NFIB members:

--A laundromat owner in Corpus Christi was sued because a lady was mugged in one of his laundromats. He refused to pay, but his insurance company settled with the lady out of court. In 1985 he paid $900 for$2 million in coverage. In 1986 he paid $3,625 for $1 million in coverage.

--A small chemical company (14 employees) in Gulfport, Mississippi paid $4500 for $300,000 coverage. In 1986 they were quoted a premium of $38,000 for $500,000 coverage.

--A campground in Hagerstown, Maryland in 1985 was charged less than $1000 for $1 million in coverage. In 1986 the same coverage cost $8000.

--A plumbing and heating contractor in Warren, New Jersey received notice that his policy had been cancelled without explanation.

--An aircraft corporation in Waco, Texas paid $25,000 in 1983, $50,000 in 1984, and $200,000 in 1985 for $2 million in coverage.

--A five-and-dime store in New Lexington, Ohio has seen premiums increase 20% between 1984-1985 and 50% between 1985-1986.

--A manufacturer of food processing machinery in Marblehead, Ohio paid $50,000 with a $2500 deductible in 1985. In 1986 the premium was $150,000 with a $50,000 deductible. The 1986 policy also required the manufacturer to pay legal expenses for settling claims and to provide a letter of credit to the insurer in the amount of $300,000.

--An elevator repair and maintenance company on Staten Island paid $3500 for $5 million in coverage in

1984. In January 1985 the policy cost $17,500. In July 1985 the policy was cancelled. Another carrier offered coverage for $72,000 in annual premiums.

--An auto parts and towing company in Walton, Ohio was charged $20,000 in 1986 for coverage which cost $11,000 in 1985.

--An insurance agent in Boundbrook, New Jersey received notice from two companies that they were no longer accepting any applications for commercial liability insurance. Also, these companies were reviewing all renewals for possible termination.

NFIB believes there must be a comprehensive solution to the insurance liability crisis. We believe that there are three causes which have contributed to the problems facing us today:

(1) An out-of-control tort system;
(2) Poor insurance industry business practices;
(3) A patchwork quilt of haphazard state regulations.

Recognizing multiple causes of the problem requires us to look at multiple solutions. It would be irresponsible to attack one problem area, resolve it, then walk away from this issue thinking it is solved. There must be a comprehensive approach and solution.

Furthermore, NFIB members do not want to single out one individual, group, or institution to blame for the crisis. They only want it resolved so they may go about their business -- the business of small business, generating new wealth and creating virtually all the new jobs in this nation.

NFIB members believe an appropriate approach should include a national uniform product liability law, comprehensive tort reform, and pro-competitive changes made in the current structure of the insurance industry. It is not the intention of NFIB to "bash" insurance companies, lawyers, or state regulators in attempting to jawbone the price of insurance down and to expand its coverage. It _is_ and will be our aim to work for those fundamental changes which will bring about better coverage at a lower price.

NFIB Mandates

As you probably know, The National Federation of Independent Business is a lobbying group which bases its policy on the views of its membership. Issue positions percolate up from grassroots, rather than being imposed on the more than 500,000 members from our President or the Board of Directors. NFIB is very proud of its decision-making process, most especially because we keep in close touch with the issues important to the membership.

NFIB hears from the membership by a combination of surveys, meetings, daily contact by our field force, and through the use of the Mandate. The Mandate, in particular, is a bi-monthly poll sent to all members to solicit their views on issues. Members are asked to take a position on an issue based upon their own beliefs and experiences. They are provided with an objective background summary on the issue. The members complete the Mandate and send it back to NFIB. The results are tallied and used for work on Capitol Hill. All of you receive a summary of the Mandates from NFIB so you, too, know what your small business constituents are thinking. Using the Mandate is how NFIB has developed its position on insurance. The following positions represent the basic views of NFIB members on liability insurance reform:

	Membership Mandate Vote
*Comprehensive tort reform (return to a fault-based standard, elimination of joint and several liability;	81% Favor 10% Oppose 9% Undecided
*Uniform national product liability law;	65% Favor 27% Oppose 8% Undecided

*An expedited claims process;	65% Favor 23% Oppose 14% Undecided
*Federal minimum standards for insurance companies to follow; and	26% Favor 67% Oppose 7% Undecided
*Elimination of the antitrust exemption provided in the McCarran-Ferguson Act.	60% Favor 26% Oppose 14% Undecided

The Cause of the Crisis

There is, as you know, wide disagreement on the circumstances which led to the current crisis. The main dispute is between the insurance industry and the trial lawyers. The insurance industry lays most of the blame for the situation on the attorneys and the civil justice system. They claim that excessive litigation, overly generous court awards, and greedy attorneys have strained insurance reserves and thus raised the costs of underwriting. While admitting that they underpriced insurance to gain investment capital when interest rates were high, they maintain that tort reform is the answer to the problem.

The attorneys accuse the insurance companies, disclaiming the notion that Americans have become more litigious and that attorneys do little to discourage frivolous lawsuits. They contend that most of the problems are due to poor management of investments made by the insurance companies, and they point to the companies' strong performance in the stock market as evidence of the healthy financial status of the industry as a whole.

Still one other group must be mentioned. State regulators -- the insurance commissioners -- have done little finger-pointing except at erroneous predictions regarding interest rates, upon which they made many decisions. Although they must operate within statutory limits, they all have authority to review rates either before or after implementation. However, like state tort law, the theory and practice of insurance regulation varies widely from state to state.

We see some truth to all sides' arguments.

Tort Reform

There are a number of reasons to support comprehensive tort reform. First, there is no question that the operability of our civil justice system is being undermined by excesses. Million-dollar awards are becoming more commonplace. Court caseloads are growing by leaps and bounds. Tort reform is needed to address these problems.

Second, these excesses translate into costs and uncertainty for insurers. Controlling awards and contingency fees and limiting liability will help control insurers' costs and help them determine risk, consequently reducing premiums and improving insurance availability.

A third reason to support the proposed legislation is to keep U.S. companies competitive in the world marketplace. Domestic companies that move offshore to avoid high costs of insurance reduce the number of manufacturers among which to spread risk in this country and thereby cause insurance rates to increase. It is a Catch-22.

Finally, tort reform has been thoroughly studied, and there is relatively widespread familiarity with the concepts involved.

NFIB is a charter member of the American Tort Reform Association (ATRA), a coalition of business groups in favor of tort reform. NFIB membership supports tort reform at both the state and federal levels. In addition to the Mandate polls noted above, in twenty-four states NFIB state directors have polled member opinions on various reforms of state tort law, and those results have likewise indicated their support. We support the following reforms, which many of the state legislatures have either passed or are considering:

1. Return to a fault-based standard for determining liability,
2. Abolish joint and several liability,
3. Modify pure comparative negligence standards,
4. Cap awards for noneconomic damages,
5. Limit contingency fees,
6. Implement alternative dispute resolution (ADR) mechanisms,
7. Penalize parties that engage in frivolous litigation,
8. Require judges/juries to itemize elements of awards,
9. Require judges/juries to consider collateral sources of compensation in determining awards,
10. Eliminate "ad damnus" clauses,
11. Allow payments of awards in installments.

Major tort reform legislation has been introduced in both the House and Senate. Congressman Bill Richardson of New Mexico has introduced H.R. 1115, a comprehensive product liability reform bill. While the bill does not include all reforms we might like to see, it is a good start down the road toward improving our civil justice system with regard to product liability cases. H.R. 1115 has engendered widespread support from the business community. Hearings on the issue have begun in the Energy and Commerce Committee, and we would urge the members of the Small Business Committee to do what they can to assure mark-up and reporting of the bill in the near future.

In the Senate, Senators McConnell, Kasten and Danforth have introduced bills addressing the need for tort reform. Senator McConnell's bill, S. 554, offers comprehensive tort reform, encompassing more than just the product liability area. The Danforth and Kasten bills, S. 666, S. 687 and S. 688, focus specifically on product liability and offer substantial reforms in this area. In addition, the Administration has proposed tort reforms, introduced as S. 711 in the Senate and as a part of their competitiveness package, H.R. 1155, in the House.

These bills include the types of reform NFIB supports. Only one provision contained in some tort reform proposals gives NFIB members concern and has split the business community. That provision is the elimination of the employer's right of subrogation. NFIB members voted 72% favor of subrogation. Currently most states allow an employer to recover from the manufacturer the cost of workers' compensation payments made to an employee who wins a product liability suit. Federal preemption of state law in this regard is not pure tort reform and should not be part of a tort reform package.

Overall, these bills promote the reforms we desire. While this Subcommittee does not have direct jurisdiction over the bills, we urge you to use your influence on behalf of the small business community to urge the committees of jurisdiction to act on these tort reform proposals.

Insurance Industry Reform

Has the market failed? That is the fundamental question many are asking today about the insurance market, because its answer has profound public policy implications. The industry itself has blamed the soaring premiums and reductions in coverage on previous cut-throat competition, i.e. too much competition among those in the industry. Other experts have argued that there exists a business cycle for insurance; we are currently experiencing the "bust" of the cycle, with better times to follow. There are others who believe the market has failed and offer the solution of increased federal regulation. No consensus has emerged to answer this question.

NFIB believes the market process itself has not failed. We view the current, complex insurance environment as one in which competition within the market has been hindered.

Our membership is generally concerned about the exercise of discretion by insurance companies in cancelling or not renewing policies. Notification periods are often short, and little if any explanation is given to the policyholder. Claims history seems to have no bearing on an insurer's decision to cancel or not renew. Industrywide cancellations leave insurance agents hard pressed to obtain coverage for clients, and small business owners have neither the time nor the expertise to seek out coverage for themselves. These are problems which insurance companies must come to grips with and solve. Not resolving these problems will increase the demand for more federal regulation of the industry.

One particular example of current law which hinders effective competition is the antitrust exemption contained within the McCarran-Ferguson Act. NFIB believes that the exemption contained within the law distorts competition in the insurance industry by its very existence.

It is the distortion of the market which compels us to urge the repeal of the antitrust exemption contained with the 1945 law.

The repeal of the antitrust exemptions contained within the McCarran-Ferguson Act makes sense for two reasons in today's environment. First and foremost, there is no market-based reason why there should be an antitrust exemption. Because there is no market-based justification, continuing the exemption is unfair and represents intrusion into the free economy by the federal government. Our antitrust laws were instituted to set the parameters for competition. Exemption from these laws represents a special interest granted to a specific industry. NFIB members want to see a level playing field for all companies, including those in the business of insurance. They believe the antitrust exemption hinders competition.

Second, the reason for the continuation of the antitrust exemption, passed by Congress to ward off a court-inspired regulatory crisis, no longer makes judicial sense. We need to simply accept that the business of insurance is, in fact, interstate commerce and needs to be under the scope of antitrust laws.

Should legislation come before the House for consideration which would eliminate the antitrust exemption in the McCarran-Ferguson Act, Congress should continue to insist that the business of insurance be regulated by the states. State regulation of insurance must continue to be the clear intent and priority of Congress. Furthermore, there may need to be some legislative language added to the bill which makes clear the understanding that joint historical data collection is important for small and mid-sized insurance companies; this would be one more assurance that pro-competitive activities would continue.

I would like to point out, Mr. Chairman, that while NFIB supports the elimination of the antitrust exemption contained within the McCarran-Ferguson Act, NFIB membership does not support the "federalization" of insurance regulation or the establishment of a new agency or department to oversee the insurance industry.

There is a limited role for the federal government to play in this issue; that is, one of analysis. NFIB has been encouraged by the recent statements of Federal Trade Commission Chariman Dan Oliver, who has said he would like to investigate the business of insurance. NFIB believes Chairman Oliver parallels many of our concerns and would pursue a policy to increase competition so insurance coverage will be more affordable and allow for greater coverage. Although the prohibition Congress placed on the FTC in 1980 is under the jurisdiction of the House Energy and Commerce Committee, NFIB hopes that you relay to your colleagues our interest in this issue.

Conclusion

Representing the more than 500,000 members of the National Federation of Independent Business, I want to impress upon you, Mr. Chairman and members of the Subcommittee, that the liability insurance crisis has not gone away. We look to you, our legislative branch, for assistance in resolving the problems which contributed to the crisis we are currently going through and, equally important, taking the necessary steps to ward off another crisis in the future.

Small businesses, many of which are marginal firms to begin with, have felt the severe impact of the liability crisis. Quite a number of businesses could simply no longer afford coverage, when coverage was available, and had to close their doors. Still other firms saw their profit margins evaporate or had to pass their skyrocketing premiums directly on to their customers in the form of higher prices. Clearly, as a result of the crisis, we experienced less job creation, less "competitiveness", and lower economic growth.

This Subcommittee has a crucial role to play as ombudsman for the small business community. I hope, and the members of NFIB hope, that one of your top legislative priorities is resolving the liability insurance crisis.

Thank you, Mr. Chairman.

0282T

FINAL RECOMMENDATIONS

THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS

August 17-21, 1986

1. Because the liability insurance crisis in the United States has not only become a life and death sentence to many small businesses, but also is changing adversely our way of life, we must pursue a four pronged effort at reform: civil justice reform; uniform standards for product, professional and commercial liability; regulation of the insurance and re-insurance industries; and viable affordable alternatives to liability coverage.

We, therefore, strongly urge the President, the Congress, and the state legislatures, to implement the following action as a vitally important step in alleviating the problems of availability and affordability of liability insurance to small business in America:

A. Civil Justice Reform:

1. Return to a fault based standard of liability.

2. Base causation findings on credible scientific and medical evidence and opinions.

3. Eliminate joint and several liability in cases where defendants have not acted in concert.

4. Limit non-economic damages (such as pain and suffering, mental anguish or punitive damages) to a fair and reasonable maximum dollar amount, not to exceed $250,000 in any case.

5. Restrict punitive damage awards to cases of willful and malicious conduct. The amount awarded shall go to a governmental trust fund, not the plaintiff.

6. Limit attorneys' contingency fees to reasonable amounts on a sliding scale.

7. Reduce awards in cases where a plaintiff can be compensated by certain collateral sources to prevent windfall double recovery.

8. The prevailing party in a legal action should have a statutory right to recover its costs and attorneys' fees from the non-prevailing party.

9. Impose a uniform, reasonable statute of limitations and repose in all tort actions; and hold defendants to the state-of-the-art in existence at the time the product was manufactured or the service was performed.

10. Provide for periodic instead of lump sum payments for future medical care or lost income.

11. Encourage use of alternative dispute resolution mechanisms to resolve cases out of court.

B. Federal Standards for Product, Professional and Commercial Liability:

Establish a uniform standard of fault based product, commercial, and professional liability which incorporates provisions cited in "Civil Justice Reform" above.

C. Availability and Affordability of Liability Insurance and Re-Insurance:

1. Review McCarran-Ferguson Act of 1945 as it applies to state regulation of insurance and the industry's limited exemption from anti-trust laws.

2. Promote the establishment of joint underwriting associations

and assigned risk pools.

3. A minimum of 60 days notice should be required for an insurer to non-renew a policy or to increase its unit premium by more than 25 percent. Mid-term cancellations should be prohibited and premiums should be based on experience ratings.

4. Promote tax deductible self-insurance through risk pooling and other group arrangements, including the expansion of The Risk Retention Act of 1981.

5. Legislate a self-insurance system that would allow small businesses to pay premiums into a fund with pre-tax dollars which could be used for no other purpose than the payment of claims, with the fund being regulated in the same manner as any other insurance company.

6. Require the insurance industry to make complete financial disclosures by lines of insurance, so that Congress, state legislatures, and state insurance commissioners may call on it at any time.

D. Education:

Realizing that the most effective long-term solution to the liability insurance problem is a knowledgeable citizenry, we urge an ongoing education program to develop an awareness that:

1. The litigious nature of the American public will profoundly affect our way of life as the cost of public and private facilities becomes unaffordable.

2. There is no such thing as a riskless society, so each of us must assume some responsibility for his/her own safety and the normal hazards of everyday living. [R.A. 180, Liability Insurance; 1419 votes of 1715 ballots cast]